

THE ABILITY OF CONSUMERS TO PLAN THEIR FINANCIAL AFFAIRS

HEARING BEFORE THE SUBCOMMITTEE ON CONSUMER AFFAIRS OF THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE ONE HUNDREDTH CONGRESS FIRST SESSION

ON

THE PACE OF PRODUCT INNOVATION OVER THE PAST FEW YEARS AS
TECHNOLOGY, DEREGULATION, AND CREATIVITY HAVE COMBINED
TO PRODUCE AN ARRAY OF NEW PRODUCTS IN THE AREA OF FI-
NANCIAL SERVICES

NOVEMBER 5, 1987

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THE ABILITY OF CONSUMERS TO PLAN THEIR FINANCIAL AFFAIRS

THURSDAY, NOVEMBER 5, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON CONSUMER AFFAIRS,
Washington, DC.

The subcommittee met at 3:33 p.m., in room SD-124, Dirksen Senate Office Building, Senator Christopher J. Dodd (chairman of the subcommittee) presiding.

Present: Senator Dodd.

OPENING STATEMENT OF SENATOR DODD

Senator DODD. The Subcommittee on Consumer Affairs will come to order.

Today, we are going to have a hearing on the ability of consumers to plan their financial affairs. Today, this subcommittee is going to be conducting one of three hearings on this subject matter.

The pace of product innovation has accelerated over the past few years as technology, deregulation and creativity have combined to produce a dazzling—and sometimes dizzying—array of new products for consumers in the area of financial services. It is hard to believe that it was only less than 10 years ago that banking customers in this country put their money in noninterest-bearing checking accounts and low, fixed rate savings accounts. Today, banking customers can do their checking through interest-bearing NOW accounts and their savings through a variety of short- and long-term saving instruments, many of them variable rate products tied to different indices.

Moreover, consumers can choose from a large number of other investment products, some of which are quite close to banking products in terms of producing a safe return.

It is clear that this revolution in the marketplace can be enormously beneficial to the educated consumer. But in its present state, there are so many products with noncomparable terms and conditions, that it is impossible for the busy consumers of today to shop efficiently. And when consumers cannot compare products simply, both consumers and competition suffer.

During the past year this subcommittee has looked into two specific examples of these problems—credit cards and savings accounts. The subcommittee is considering, I would add, legislation in both areas that would give consumers much needed standardized disclosures, so that they can compare options.

Today, we are expanding our examination of these issues to look more broadly at the consumer in today's deregulated environment. How has the marketplace for savings and investment vehicles changed? How has the consumer changed: what is the impact of more women in the workplace and of more two-worker families in the United States? What is the effect of having more divorced people? What are the special needs of the elderly and the handicapped? What is our educational system doing to help consumers make important decisions?

We will also examine what role the Congress can or should play, if any, in helping consumers work their way through this forest of investment instruments. Should we require more disclosure of information? If so, of what information? Should we standardize some of the basic terms and conditions, as we do with such products as automobile and home owners insurance? Should we try to legislate for different types of consumers.

These are just a few of the many questions that we need to explore. Today's hearing will focus on self-help issues: what can be done to help consumers plan their own financial affairs. The next hearing we will hold, which will be on November 18, I would add, will look at one new product of this universe—the home equity loan. Finally, early next year, the subcommittee will conduct a hearing on the role of financial planners. Where do consumers turn when they cannot plan their own affairs or when they lack the time to do so? What kind of services are consumers getting for their money?

Once we have completed these hearings, I think the subcommittee will have a far better idea of what needs to be done to enable consumers to take advantage of the benefits of deregulation.

Today, we are going to hear from a distinguished group of witnesses who have devoted a significant amount of their professional careers to addressing the issues before this subcommittee. Not only have they studied what is happening in the United States, but as we will hear from one witness, Jeremy Mitchell, who has just completed editing a book on an international conference addressing many of the same questions on a global basis.

With that opening statement, let me invite our first panel to immediately take their seats here at the witness table, Mr. Phelps, Ms. Hogarth. If you will all look, there are names on the other side as well: Ms. Hira and Ms. Stephenson.

So first of all, we welcome all of you to the committee. For purposes of introduction in the record, Dr. Mary Stephenson is a family resource management specialist for the University of Maryland, Dr. Tahira Hira is an associate professor at the Department of Family Environment at Iowa State University, Dr. Jeanne Hogarth is an assistant professor at the Department of Consumer Economics and Housing at Cornell, and Kermit Phelps, at the end, who is the Chairman of the Board of the American Association of Retired Persons.

We welcome again all of you being here. Why don't you begin in the order that I have introduced you, if that is all right. We will begin with you, Dr. Stephenson, and we will move down. And I will just tell you that all of your statements will be included in the record, as if read, and you can proceed any way you are comforta-

ble, either with the statement or a synopsis of it, however you are more comfortable.

STATEMENT OF MARY J. STEPHENSON, Ph.D., FAMILY RESOURCE MANAGEMENT SPECIALIST, UNIVERSITY OF MARYLAND, COLLEGE PARK, MD

Dr. STEPHENSON. All right. Thank you for giving me the opportunity to testify this afternoon. I would like to qualify my statements by saying I am far from an expert in banking services. I work for the Cooperative Extension Service in the State of Maryland, and the people we work with have little in the way of savings. Many cannot afford a checking account and have difficulty paying their debts. A large percentage of our families are living on the edge, barely making ends meet. Death, divorce, loss of an income, most recently from their farm business or illness pushing them over, at which time we help them deal with debt collectors, repossessions and foreclosures.

The vast majority of Americans are similar to our clientele in financial make-up. A study funded by "Money" magazine found that the median level of savings and investments was only \$4,600 in 1984. About 7 out of 10 people had some kind of outstanding loan. And it is this person, the average American, that will be most helped by the proposed legislation.

MANEUVERING IN THE WORLD OF FINANCIAL SERVICES

Less than a decade ago, consumers found it simpler to maneuver in the world of financial services. Banks were banks. They provided a place for people to save and borrow. Brokers sold stocks and bonds. Insurance agents insured lives, homes and cars. Credit cards were used to buy gasoline, consumer goods and airline tickets. Only the most sophisticated investors regularly moved beyond these confines.

Deregulation of the financial service industry has witnessed a proliferation of new products for the consumer as well as a blurring of financial institutions from which to choose.

A study by Chen and Jensen, confirmed concerns that the benefits of deregulation have not been distributed equally across all segments of the population. Their analysis suggests that those who tend to be most in need, older rather than younger, unmarried rather than married, low rather than high income, less educated rather than more educated, are less likely to be taking advantage of current reforms. Furthermore, they report to the need for improving the quality of information with which to make decisions. Their research calls for special attention to focus on clarifying the definition of interest rates across different market instruments to provide the consumer a meaningful measure of rate of return, in order to facilitate comparison shopping for different financial instruments and services.

Since deregulation we have witnessed the increase in the cost of standard banking services. Many banks now prefer big corporate accounts to individual accounts and big individual accounts to small ones. Problems are becoming so severe for low and moderate

income consumers, that it is thought by some that deregulation was a bad idea.

This is most obvious when the fees and charges on small savings accounts exceed interest rates. Hardly encouraging the limited income family to save.

According to the Consumer Federation of America, service charges on noninterest-bearing accounts for low balance depositors with relatively few transactions carried annual fees between \$56 and \$197 in a recent year. Depositors who can afford to keep \$500 or \$1,000 or more in savings or checking accounts, on the other hand pay no service charges at most banks, even though they make more deposits and withdrawals. Many banks maintain minimum balance requirements that prevent lower income people from using their services.

It is interesting that passbook and statement savings accounts have retained the bulk of their deposits in recent years, even though individuals could get much higher interest rates, if they moved their funds into certificates of deposit or money market accounts.

In 1985, some \$305 billion still sat in these accounts. Banks have not raised the interest rates on these low-cost funds. Obviously, there is no urgency to do so, since depositors seemingly lack the desire to move the funds.

In a recent study of investment behavior, attitudes and needs of middle and upper income people, it was found that passbook savings accounts were the most widely held type of investment or saving of Americans with incomes of \$40,000 or more. Seven in 10 of the 1,489 respondents reporting holding such an account. Bank money market accounts ranked next with just over half having one. Certificates of deposit were also widely held with 40 percent holding these. The study further revealed that many of these middle and upper income people lack the knowledge of basic investment concepts, as half did not know that compounding affects the yield on interest rates.

MANY SAVERS LACK KNOWLEDGE OF INTEREST RATES

A recent study indicates that 33 percent of Americans do not know the rate they earn on their savings. According to a study by "Bank Advertising News" and SRI Research, as mentioned in "USA Today," one-third of those asked, did not know what interest rate they were receiving on their certificates of deposit, money market account and interest-bearing checking account.

I feel that one of the reasons underlying this lack of knowledge is that there is no one figure which people can use to determine what they are actually receiving. No Federal laws require interest rates of savings accounts to be figured in a uniform way. Savers need something comparable to the annual percentage rate used to determine the credit costs on an installment loan. A bank paying 8 percent compounded daily can actually yield more than one paying 8.2 percent compounded semiannually, yet a saver might be lured to the second, because its rate sounds higher.

Consumer credit card rates have stayed high, because the field is dominated by large banks that have implicitly chosen not to use

lower interest rates as a way to compete with each other for customers.

The operation of a free market in the credit card field is hindered by two factors.

First, it is difficult for consumers to comparison shop. Someone who wants to compare and save would have to spend several days and hundreds of dollars calling banks around the country to discover fair rates. The small banks with low rates cannot afford to advertise nationally, and big national banks, which dominate the market, refuse to compete.

Second, consumers are not well-informed about the details of credit cards. Some believe all credit card interest rates are the same. Some feel bigger banks, whose names they recognize, are safer. Consumers need a easier method for determining the actual cost of their credit, as they contemplate annual fees, tiered pricing, grace periods, as well as variable rates.

There are few opportunities for the average consumer to gain the insight necessary for financial stability. Little is taught in the elementary and secondary schools. Though personal finance is generally taught on college campuses, it is obviously limited to those students who are fortunate to attend.

The number of magazines and newsletters specifically dealing with financial education has increased in recent years. Radio and television have expanded their coverage of financial topics. The Co-operative Extension Service has also responded by focusing more of their educational programming on the maintenance of economic well-being and remediation of financial problems. The nonprofit Consumer Credit Counseling Services offer some educational programs as they assist their clientele in managing debts. Social service agencies, credit unions, labor unions, fraternal and religious organizations also engage in financial counseling and/or education to a certain degree.

But, the opportunity for nonbiased instruction is limited. Many people confuse information with consumer education. These terms are often used interchangeably, although by definition, they are quite different. Consumer education is objective, without bias, and appropriate for classroom teaching. Consumer education, in the form of brochures, advertising, seminar presentations and the counseling provided by financial institutions, has the potential for educating the public, but it is often promotional in an effort to sell a product or service and, therefore, lacks the objectivity necessary for consumers.

People require adequate information to analyze their choices of financial products. They need basic information on such topics as the time value of money, compounding of interest and the methods used to calculate earned interest.

The proposed legislation focuses on clarification of interest rates across different market instruments, which will provide consumers with meaningful measure to comparison shop. It is my opinion that they will support those most in need of this kind of educational assistance.

It is imperative that legislatures and the banking industry address the needs and concerns of consumers. Because high costs particularly hurt low income families, it is vital to consider the cre-

ation of lifeline banking for minimum banking services at little or no cost.

The International Consumer Research Institute set out to survey the Nation's leading consumer opinion leaders on important issues facing consumers for 1987. The summary of findings states that the three most important issues that Federal agencies and Congress should address in 1987 are: financial services, health care and costs and tort reform, as it relates to insurance costs.

THREE MOST IMPORTANT CONSUMER ISSUES

The three most important consumer issues that State legislatures and agencies should address in 1987 are: Government regulations, automotive issues and financial services.

Specifically, the financial services issue dealt with deregulation and credit interest rates and the tort reform was related to liability insurance costs.

I would like to add to that list of concerns and to summon this committee to address the need for Federal regulation of the insurance industry and financial planners, limitations on the use of home equity and comprehensive education in the art of finance, and clearly, you are going to do that. Thank you.

Senator DODD. Thank you. And I am going to have to take about a 5-minute break here as I run over and cast a vote. So I apologize and will be right back.

We stand adjourned for 5 minutes.

[Recess.]

[The complete prepared statement of Mary J. Stephenson, Ph.D., follows:]

Senator DODD. The subcommittee will come to order. I guess we should all say a silent prayer that we won't have any more votes for a while, so we can proceed uninterrupted.

Dr. Hira, we would be glad to accept your testimony, as well under the same conditions.

**STATEMENT OF TAHIRA K. HIRA, Ph.D., ASSOCIATE PROFESSOR,
DEPARTMENT OF FAMILY ENVIRONMENT, IOWA STATE UNIVERSITY**

Dr. HIRA. First of all, I would like to thank you for giving me this opportunity to be here. It is an honor, and it is a pleasure.

I realize I am speaking to people who are very knowledgeable in this area, and I do commend the staff and the committee for doing such extensive research and showing such a care for consumers, and I am not sure I am going to bring up some new information for you, but I do hope that I can, maybe, reinforce some of the things that you have already thought through and supported by some of the research that we have done over the last 8 to 10 years.

We have already heard that a revolution is under way in the financial services industry, and this revolution encompasses new products, delivery systems and providers and a changing regulatory environment.

IMPACT OF THE FINANCIAL REVOLUTION

Technology is melting the market boundaries and forcing removal of the regulatory restrictions far more rapidly and completely than otherwise would be possible. The revolution has opened vast potential for improvement, improved investments, credits and payment, products and services through the data base management, automation and networking assignments.

Regulation of the financial services industry has been varied and extensive. A new market-driven industry with intense competition between financial services institutions has begun to emerge.

The extent to which technology advances in the financial services industry will benefit the consumer depends not only on the services provided but also on the willingness of the consumers to adopt new technologies.

There are several researches that would point out that maybe one-fourth of the population is ready, willing, interested to use these modern technologies and are using them, and there are statistics in the testimony that I have written that provides evidence that a smaller proportion of the population that is ready to use all this development that we are seeing.

Current and anticipated pricing strategies and technological developments may deprive low-income, physically handicapped and functionally illiterate consumers of routine financial services. Even the most agitated consumers cannot begin to understand the complexities of the many new products and services available today. This situation will worsen as deregulation progresses and more providers enter the market.

I have a few recommendations based on these developments.

The voluntary, standardized disclosures and some mandated information disclosures are recommended as trade-offs to deregulation.

Improved personnel training programs to enable employers in the financial institutions to provide assistance to the consumers, especially where pricing incentives limit the amount of human interaction with customers is recommended.

A broad-based consumer education effort could significantly reduce the number of the consumer problems resulting from the revolution in the financial services industries.

I also would like to point out that the level of money management education in our environment presently is very, very low. Several surveys have been done by "Fortune" magazine and by "Money" magazine that pointed out that the competencies of the people are very low and people feel very uncomfortable about managing their money. One of the surveys pointed out that a substantial number of the subscribers were unaware of the product diversification of the major financial institutions.

We do not teach competencies to deal with personal or family finances, to the extent and the level at which they should be taught. I think we are all aware of the fact that most of us develop a system that is our own, and we go through life struggling alone, and we are very aware of the stories like where people have changed their bank accounts from one bank to the other, because they couldn't balance the bank statements, and they thought the best thing would be close this account and move on to the next one [laughing], and I am aware of such actions personally. I am also aware of the students who have college degrees, and they have gotten married, and now the pressure of buying insurance and a home and various kinds of products was on them. The market was telling them to do all these things. They weren't prepared. They didn't know what to do.

So many of the financial products are particularly sold to people rather than bought by them after making a decision and knowing about them.

I also want to point out that even very highly educated people with whom I have interaction on a daily basis say to me, "I have done very well throughout my life, but, you know, it would be kind of nice if I knew that what I have done has prepared me well for my retirement years, and I have some insurance, and I have some investments, but I really don't know whether it is right or not."

I think that is rather sad to know that we are at the stage that people don't know what they are doing with their money and whether they have done the right management, and the reason for this is because we have never taught them how to do it. They have learned by experiences.

There are a lot of money paradoxes. People really don't understand what money does to them. Economists will tell us that we are all very rational consumers, and we know how to spend our money and how to save it, but I would ask you, is that true? Are we rational consumers all the time? And I would suggest to you that, no, we are not, because I have seen many impulsive and compulsive behaviors that are associated with money, and I think we

ought to recognize this and prepare people how to handle those kinds of behaviors.

I am going to share with you some of the research that we did at Iowa State University to learn the money management level of the college student. Now my hypotheses were that if we deal with the very educated, cream of the population which is at the colleges and their money management level is higher, we can say, well, gee, we have done very well. And of course we realize that there are a lot of people who don't even come to college.

There were five different areas in which we measured money management knowledge of college students. We learned that the students had a very low level of knowledge about insurance, about credit cards and about overall financial management areas. They knew the general things in these areas, but when it came to the specific information and the application or assessment or evaluation of that information, the level of knowledge was very, very low. Some of the characteristics of students with a higher level of knowledge were: males, married and older students, as compared to females, singles and younger students.

It tells me that we weren't teaching them. They were learning through their experience.

I am also aware that most college curricula have very little emphasis on preparing students to effectively manage their money throughout their life.

STUDENT LOAN PROBLEMS

Now we have also been hearing about problems with student loans, there's lots of people who do not keep up with loan payments. And I think there is a reason for us to be talking about student loan problems. There should be personal finance courses that should be available and accessible to all students. Personal finance students should emphasize skills to make decisions and to process information, and because of the complexities of the market and the time constraints that are facing consumers, personal finance courses should also include topics, such as the use of the competent adviser.

I am going to share some of the results of the studies that we have done to learn whether it is the money management practices that affect the household solvency status and their satisfaction with financial status, or is it the amount of resources that they have? Well, we learned that the largest proportion of the consumers did not appear to have an understanding of the credit market. Education and income are the key determinants of the knowledge and understanding of consumer credit.

High income and highly educated consumers are more likely to know about credit than are the low income consumers with less formal education.

The younger respondents and those with larger households paid finance charges more frequently than did those who were older and were smaller households. Education of the respondent, household size and household income were significantly related to the knowledge of credit.

It is concluded that credit practices are influenced by the knowledge of credit; by increasing the knowledge of various aspects of consumer credit, credit practices can be improved.

As I earlier mentioned, it is not only the size of resources but also the effective management of the given resources that contributes to families' ability to successfully function in their given economic environment. The individual factors, such as money management practices and attitudes toward use of consumer credit, significantly influence the families' strength and ability to manage their given resources effectively.

Three areas with which a smaller proportion of the respondents were satisfied, included ability to meet emergency expenses. Only 40 percent of the people were satisfied. Ability to save and the size of assets. Solvency status, which is measured by debt to income ratio of the household, was affected by the respondent's age, housing status, use of credit cards, an attitude toward borrowing and size of monthly debt payments.

Relatively insolvent respondents used a larger number of credit cards, felt comfortable in owing larger sums, made larger monthly debt payments and were younger and had larger households. They rented their homes and were less satisfied with their financial situation.

A very interesting area in money management is the risk management area. Although a majority of the households in our study had various types of insurance, such as life, auto, liability and disability, only a small proportion of the respondents were satisfied with their ability to meet their emergency expenses. It is a very interesting question that needs to be further researched, and I can just present certain hypotheses.

1. They did not understand their coverages.

2. They did not know whether—maybe they had doubts about whether their insurance will come through when the emergency really struck. Maybe they were concerned about the deductibles and the amount that they would have to come up with, or maybe they were thinking about some other risks that were not covered by insurance. I really don't know what it was.

But nevertheless, it is an interesting finding. We have a majority of people who have insurance coverages and yet they feel that they are not ready to meet their emergencies, emergency expenses.

OPINION OF HOUSEHOLD ASSET OWNERSHIP

I am going to say a few things about the household asset ownership. The level and composition of the financial asset ownership is crucial for household security. If the household owns a certain level of asset. For example, if the assets are equal to 3 months of the take-home pay, the household is believed to be capable of responding to financial emergencies without facing financial crises. This can also enable the household to purchase durables without incurring large amounts of debt.

In addition to the level of assets, the composition of assets is also crucial. A household needs to make an educated decision about types of assets, taking into account such characteristics as liquidi-

ty, level of risk, rate of return, tax treatment and the extent of knowledge and time that asset management may require.

The level and mix of asset ownership of all households is directly related to the overall functioning of the economy. Size and composition of household is also important for the economic, large economy, as well as for the small economy, which is the household economy. A majority of the households, 60 to 70 percent, owned assets like current accounts, savings accounts. They identify automobiles, household furniture, homes and cash value life insurance as their assets, and certificates of deposit. A smaller proportion of the households, which is less than 30 percent, reported investments in mutual funds, stocks and bonds and retirement accounts. I think my question is, that why is it that more people are not investing in IRA's and mutual funds. People are either uncomfortable with these products, or they are uninformed about these investments. And the findings are of some value to, particularly for both personal finance educators and for the financial institutions that are selling these products.

Again, my recommendations are that the financial courses should emphasize risk management topics, investment topics. We need to know more about the other university students if they are more knowledgeable than Iowa State University, and I think we should also have some more studies that tell us about the casual relationship among the knowledge of credit attitudes and the current practices and their impact on the household solvency.

I would also like to point out that the financial problems have great impact on families, as a whole. There are two kinds of studies that have been in this area. One type of studies are in the area of consumer bankruptcy and the others that have focused on stress and conflicts caused by financial problems.

CONSUMER BANKRUPTCY INCREASING

The number of people resorting to bankruptcy has been consistently on the increase, and there appears to be a number of factors causing bankruptcy. Most of them can be grouped into three areas—personal problems, employment problems, credit and financial problems.

But I think the finding that is of great concern to us is that more and more studies are pointing out that approximately 48 percent or close to half of those who are declaring bankruptcies identify credit problems as a leading factor in the decision to declare bankruptcy. Researchers have also found that the decision about borrowing depends upon whether individuals think that their current income can support another monthly payment rather than looking at the total amount that they are borrowing and the cost of the purchase.

Based on the results of several studies, one can conclude that a debtor in bankruptcy is usually an employed male who is in his thirties, works in a blue collar occupation, has 10 to 12 years of education and earns on average \$14,000, and they owe money to about 10 to 12 different sources.

But I think the findings that are of great concern are that this profile is changing. A larger proportion of females, white collar workers, middle income people, highly educated and older, which is

40-plus, are also now being seen in increasing proportions in these studies.

It has also been found that the discharged bankrupts still lack credit knowledge. Many of the bankrupts who were interviewed were afraid to handle credit after declaring bankruptcy.

I think if somebody is going to go through this process of bankruptcy, we would hope that they come out and next time they would be able to manage their credit wisely and would not have to declare bankruptcy again. And I don't think that is happening. Some of the informal discussions that I have had with the bankruptcy lawyers, when we were talking about the farm bankruptcies, also indicated that the knowledge in the area of management, whether it was farm finances or family finances, and use of the credit were culprits of the farm bankruptcies.

Empirical studies also indicate that the stress and conflict caused by financial problems can have detrimental effects on individuals within the family and on family relations. We have also seen the conflict over handling financial resources places severe strain in the family relationships and is one of the major factors in divorce. We have also seen that association between various forms of family violence and specific stressful and most severe cases of child abuse, also occur where the family is facing unemployment.

So I think my recommendation in this area is that agencies and organizations that are committed to help families need to be aware of the impact of financial problems on family problems, and a holistic program, which includes family counseling and financial counseling should be provided and populations that are more in need of this kind of help should be targeted, and coordinated efforts of the support group within the community should be put together.

I have a whole list of the implications for the educators and researchers in my written testimony, and I think I will just stop there.

[The complete prepared statement of Tahira K. Hira, Ph.D., follows:]

Testimony, November 5, 1987
Consumer Affairs Subcommittee
U.S. Senate Committee on Banking

Thank you for giving me the opportunity to testify this afternoon. I would like to qualify my statements by saying I am far from an expert in banking services. I work for the Cooperative Extension Service in the state of Maryland and the people we work with have little in the way of savings. Many cannot afford a checking account and have difficulty paying their debts. A large percentage of our families are living on the edge, barely making ends meet. Death, divorce, loss of an income (most recently their farm business), or illness pushes them over, at which time we help them deal with debt collectors, repossessions and foreclosures.

The vast majority of Americans are similar to our clientele in financial make-up. A study funded by Money magazine found that the median level of savings and investments was only \$4,600 in 1984. About seven out of ten people had some kind of outstanding loan. And, it is this person, the average American that will be most helped by the proposed legislation.

I was asked to answer specific questions today, the first one being:

What did consumers face in the marketplace prior to deregulation?

Less than a decade ago, consumers found it simpler to maneuver in the world of financial services. Banks were banks. They provided a place for people to save and borrow. Brokers sold stocks and bonds; insurance agents insured lives, homes and cars. Credit cards were used to buy gasoline, consumer goods and airline tickets. Only the most sophisticated investors regularly moved beyond these confines.

What financial instruments are available since deregulation?

Deregulation of the financial services industry has witnessed a proliferation of new products for the consumer as well as a blurring of financial institutions to choose from.

Savings Rates

A study by Chen and Jensen (1985) confirmed concerns that the benefits of deregulation have not been distributed equally across all segments of the population. Their analysis suggests that those who tend to be most in need, e.g., older rather than younger, unmarried rather than married, low rather than high income, less educated rather than more educated, are less likely

to be taking advantage of current reforms. Furthermore, they point to the need for improving the quality of information with which to make decisions. Their research calls for special attention to focus on clarifying the definition of interest rates across different market instruments to provide the consumer a meaningful measure of rate of return in order to facilitate comparison shopping for different financial instruments and services.

Since deregulation we have witnessed the increase in the cost of standard banking services. Many banks now prefer big corporate accounts to individual accounts and big individual accounts to small ones. Problems are becoming so severe for low and moderate income consumers, that it is thought by some that deregulation was a bad idea. This is most obvious when the fees and charges on small savings accounts exceed interest earnings...hardly encouraging the limited income family to save.

According to the Consumer Federation of America (Foreman), service charges on non-interest bearing checking accounts for low-balance depositors with relatively few transactions carried annual fees between \$56 and \$197 in a recent year. Depositors who can afford to keep \$500 or \$1,000 or more in savings or checking accounts, on the other hand, pay no service charges at most banks, even though they make more deposits and withdrawals. Many banks maintain minimum balance requirements that prevent lower income people from using their services.

It is interesting that passbook and statement savings accounts have retained the bulk of their deposits in recent years, even though individuals could get much higher interest rates if they moved their funds into certificates of deposit or money market accounts.

In 1985, some 305 billion dollars still sat in these accounts. Banks have not raised the interest rates on these low-cost funds. Obviously, there is no urgency to do so since depositors seemingly lack the desire to move their funds.

In a recent study of investment behavior, attitudes and needs of middle and upper income people (Crespi and Associates), it was found that passbook savings accounts were the most widely held type of investment or saving of Americans with incomes of \$40,000 or more. Seven in ten of the 1,489 respondents reported holding such an account. Bank money market accounts ranked next with just over half having one. Certificates of deposit were also widely held with forty percent holding these. The study further revealed that many of these middle and upper income people lack knowledge of basic investment concepts as half did not know that compounding affects the yield on interest rates.

A recent study indicates that 33 percent of Americans do not know

the rate they earn on savings. According to a study by Bank Advertising News and SRI Research as mentioned in USA Today, one-third of those asked did not know what interest rate they were receiving on their certificates of deposit, money market account or interest bearing checking account.

I feel that one of the reasons underlying this lack of knowledge is that there is no one figure which people can use to determine what they are actually receiving. No federal laws require interest rates on savings accounts to be figured in a uniform way. Savers need something comparable to the annual percentage rate used to determine the credit costs on an installment loan. A bank paying 8 percent compounded daily can actually yield more than one paying 8.2 percent compounded semiannually. Yet, a saver might be lured to the second because its rate sounds higher.

Credit Rates

Consumer credit card rates have stayed high because the field is dominated by large banks that have implicitly chosen not to use lower interest rates as a way to compete with each other for customers.

The operation of a free market in the credit card field is hindered by two factors. First, it is difficult for consumers to comparison shop. Someone who wants to compare and save would have to spend several days and hundreds of dollars calling banks around the country to discover fair rates. The small banks with low rates cannot afford to advertise nationally, and the big national banks, which dominate the market refuse to compete. Second, consumers are not well informed about the details of credit cards. Some believe all credit card interest rates are the same. Some feel bigger banks whose names they recognize are safer. Consumers need an easier method for determining the actual cost of their credit as they contemplate annual fees, tiered pricing, grace periods as well as variable rates.

What educational opportunities or lack of opportunities are available to learn how to plan financial affairs?

There are few opportunities for the average consumer to gain the insight necessary for financial stability. Little is taught in the elementary and secondary schools. Though personal finance is generally taught on college campuses it is obviously limited to those students who are fortunate to attend.

The number of magazines and newsletters specifically dealing with financial education has increased in recent years. Radio and television have expanded their coverage of financial topics. The Cooperative Extension Service has also responded by focusing more of the educational programs on the maintenance of economic well being and remediation of financial problems. The nonprofit

Consumer Credit Counseling Services offer some educational programs as they assist their clientele in managing debts. Social service agencies, credit unions, labor unions, fraternal and religious organizations also engage in financial counseling and/or education to a certain degree.

But, the opportunity for non-biased instruction is limited. Many people confuse consumer information with consumer education. These terms are often used interchangeably although by definition they are quite different. Consumer education is objective without bias, and appropriate for classroom teaching. Consumer information, in the form of brochures, advertising, seminar presentations, and the counseling provided by financial institutions has the potential for educating the public. But, it is often promotional in an effort to sell a product or service and therefore lacks the objectivity necessary for consumers.

What is your reaction to the two bills?

People require adequate information to analyze their choices of financial products. They need basic information on such topics as time value of money, compounding of interest and the methods used to calculate earned interest.

The bills focus on clarification of interest rates across different market instruments which will provide consumers with a meaningful measure to comparison shop. It is my opinion they will support those most in need of assistance.

Suggestion or comments as committee prepares consumer legislation.

It is imperative that legislators and the banking industry address the needs and concerns of consumers. Because high costs particularly hurt low-income families, it is vital to consider the creation of "lifecycle banking" for minimum banking services at little or no cost.

The International Consumer Research Institute set out to survey the nation's leading consumer opinion leaders on important issues facing consumers for 1987. The summary of findings states that the three most important issues that federal agencies and Congress should address in 1987 are: financial services, health care and costs, and tort reform/insurance costs.

The three most important consumers issues that state legislatures and agencies should address in 1987 are: government regulations, automotive issues, and financial services.

Specifically, the financial services issues dealt with deregulation and credit interest rates and the tort reform was related to liability insurance costs.

I would like to add to that list of concerns and to summon this committee to address the need for federal regulation of the insurance industry and financial planners, limitations on the use of home equity, and comprehensive education in the area of finance.

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PERSONAL FINANCIAL MANAGEMENT: THE NEED FOR EDUCATION

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Introduction

This paper begins by reviewing changes in the financial services industry and their impact on consumers' finances. Second, consumers' level of money management knowledge is assessed. Third, research findings indicating factors related to consumers' satisfaction with financial status and financial solvency are summarized. Fourth, causes for consumer bankruptcies and characteristics of those facing financial difficulties are described. Finally, areas for education and research are proposed.

Technology and Deregulations

A revolution is underway in the financial services industry. This revolution encompasses new products, delivery systems, providers, and a changing regulatory framework. The implications of this revolution for consumers, educators, and researchers are beginning to unfold.

Technology is melting market boundaries and forcing removal of regulatory restrictions far more rapidly and completely than otherwise would be possible under all but the most extreme economic conditions. The revolution in electronics, particularly in computers and telecommunications, has opened vast potential for improved investment, credit and payment, products, and services through database management, automation, and networking arrangements.

Regulation of the financial services industry, broadly defined to include banks, savings and loan associations, credit unions, stock brokerage houses, and insurance agencies, has been varied and extensive. It appears that

deregulation, or the removal of controls on price or quantity of financial products and services, is creating conditions under which any financial institution can offer any product or service at any price anywhere. A new market-driven industry with intense competition between financial service institutions has begun to emerge.

Deregulation and technology have spawned convenience, increased options, prospects for financial gain, and new consumer concerns. The extent to which technological advances in the financial services industry will benefit the consumer depends not only on the services provided, but also on the willingness of customers to adopt new technologies. According to a survey conducted by *Money* (William and Marshall, 1984), only 25 percent of the people surveyed had used personal computers, 36 percent had used automatic teller machines, and 30 percent opposed using home computers for banking and catalogue shopping. Only 20 percent favored buying stocks, bonds, mutual funds, and insurance via home computers. Mostly it's higher income, better educated, and younger people who are more likely to favor the use of high technology for the management of their finances.

The issue of access to financial services encompasses cost of service, exclusion, credit availability, and choice. Current and anticipated pricing strategies and technological developments may deprive low-income, physically handicapped, and functionally illiterate consumers of routine financial services.

It is feared that mass movement of capital around the country and the world may deprive consumers and small businesses of credit. Subtle coercion may deprive consumers of their freedom of choice. Mandatory direct deposit of checks, check truncation, pricing differentials for human versus automatic

tellers, and conversion of branches to ATMs are cited examples of service restriction.

Even the most educated consumers cannot begin to understand the complexities of the many new products and services available today. This situation will worsen as deregulation progresses and more providers enter the market.

Recommendations

1. Voluntary, standardized disclosures and some mandated information disclosures are recommended as tradeoffs to deregulation.
2. Improved personnel training programs to enable employers in financial institutions to provide assistance to consumers, especially where pricing incentives limit the amount of human interaction with customers, is recommended.
3. A broad-based consumer education effort could significantly reduce the number of consumer problems resulting from the revolution in the financial services industry.

Money Management Knowledge

Rapid changes in the financial services industry present many challenges for educators. A *Fortune Magazine* reader survey has shown that substantial numbers of subscribers were unaware of the product diversification of major financial institutions. Readers voiced concern about their ability to manage personal finances due to the pressures of other interests (Fortune, 1983).

Danes and Hira (1987) studied the money management knowledge level of

college students at Iowa State University, to identify those student characteristics that help explain differences in knowledge. The five areas of money management knowledge covered include credit cards, insurance, personal loans, record keeping, and overall financial management. Although care must be taken not to generalize the results to all student populations, the findings indicate the need for education in specific money management areas.

Students participating in this study demonstrated low levels of knowledge in insurance, credit cards, and overall financial management areas. The college students often know general facts about money management topics, but they lack knowledge of specifics. For example, they know credit cards can be used as identification and they know the various costs involved in using credit cards. However, they do not know what to do if there are any billing errors and how different credit cards have different costs. Similarly, students know the importance of medical and life insurance; but specific knowledge regarding auto collision insurance and the rate of return of cash value life insurance is low. Knowledge level among students was also low in other specific areas of overall financial management, including consolidation loans, mortgage interest tax deductibility, IRAs, current APR, and security of money market funds.

The results help to identify student populations that would benefit most from educational money management programs. Males, married, and older students exhibited a higher level of knowledge as compared to females, singles, and younger students. Males knew more about insurance and personal loans, but females knew more about overall financial management. Increasing age and marriage seem to provide impetus or the necessity for learning more about money management.

Many students are in college to prepare for an income-earning career

However, most college curricula put very little emphasis on preparing students to effectively manage the money they earn. In addition, more students are taking on greater amounts of debt to acquire education.

Many students marry during their college years or soon after. Their knowledge level affects their family's financial well-being. The spending and saving behavior of young families is related not only to their current and future earning capacity but also to the positive or negative response provoked by social expectations. Young families' financial situations are complicated by the fact that many young couples are unsophisticated regarding moderately effective and compatible ways of handling their income.

Recommendations

1. Personal finance courses should be available and accessible to all students at the college level.
2. Personal finance courses should emphasize skills to make decisions and to process information.
3. Because of the complexities of the market and the time constraints facing consumers, personal finance courses should include topics such as the use of competent advisors and evaluation of advisors' recommendations.

**Factors Related to Satisfaction with Financial Status
and
Financial Solvency**

Knowledge, attitudes, and practices in the use of credit

Household financial management practices and, in particular, credit practices are very important in the determination of the financial status of households. Increasingly more and more consumer transactions have some involvement with credit. Households with similar resources can have radically different financial statuses, depending upon their credit practices.

A large proportion of consumers do not appear to have an understanding of the credit market. Education and income are key determinants of knowledge and understanding of consumer credit. High income and highly educated consumers are more likely to know about credit than are low income and consumers with less formal education.

There is also some relationship between knowledge and current credit use. Consumers with more knowledge about credit use credit to a greater extent than those with little knowledge. The studies that include attitudes toward credit as a variable have concluded that people with more favorable attitudes toward installment debt use more of this type of credit.

Upper income consumers and younger consumers have more favorable attitudes toward credit than do lower income and older consumers. It has also been found that more highly educated consumers approve of the use of credit more than do those with less education.

A study conducted in Iowa (Danes and Hira, 1986) concluded that respondents with a higher score on knowledge indicators felt comfortable owing more money on credit cards and also had a larger number of cards. These

respondents had larger households and a higher income and education level compared to the other respondents. Younger respondents and those from larger households paid finance charges more frequently than did those who were older and were from smaller households.

Education of the respondent, household size, and household income are significantly related to knowledge of credit. There is a significant relationship between knowledge of credit and attitudes toward credit. It is concluded that credit practices are influenced by knowledge of credit. By increasing knowledge of various aspects of consumer credit, credit practices can be improved.

Factors influencing satisfaction with various aspects of households' finances

It can be hypothesized that families with greater economic resources are better able to cope with the uncertain and complex economic environment than those with fewer resources. However, it is not only the size of resources but also the effective management of given resources that contributes to families' ability to successfully function in their given economic environment. Individual factors such as money management practices and attitudes toward use of consumer credit significantly influence a family's strength and ability to manage their given resources effectively.

Based on the results of personal interviews conducted with randomly selected households, Hira (1986) concluded that the majority of the respondents (70% or more) were satisfied with most aspects of their household finances. Three areas with which a smaller proportion of respondents were satisfied included: 1. ability to meet emergency expenses (44 percent);

2. ability to save (40 percent); and 3. size of assets (45 percent).

A large proportion of respondents were married, had smaller households, saved a portion of their income, were solvent, and were satisfied with their household financial status.

Solvency status (debt-to-income ratio) of a household was affected by the respondents' age, housing status, use of credit cards, attitude toward borrowing, and size of monthly debt payments. Relatively insolvent respondents used a larger number of credit cards, felt comfortable in owing larger sums, made larger monthly debt payments, were younger, had larger households, rented their homes, and were less satisfied with their financial situation.

Risk management practices

Although a majority of households in the Hira (1986) study had various types of insurance coverages (life, auto, liability, disability), only a small proportion of respondents were satisfied with their ability to meet emergency expenses. Possible explanations for this outcome include:

1. Respondents had insurance coverage, but their coverage was not adequate to meet their needs.
2. They did not know the nature and extent of their insurance coverage.
3. They were concerned about their ability to meet emergency expenses incurred due to deductibles.
4. They did not feel that when a loss occurred the insurance provider would come through.
5. They were concerned about those general personal risks for which insurance coverage can't be purchased.

Money management practices influencing household asset ownership

The level and composition of financial asset ownership is crucial for household security. If a household owns a certain level of assets (for example if the assets are equal to 3 months' take-home pay), the household is believed to be capable of responding to financial emergencies without facing financial crisis. This can also enable the household to purchase durables without incurring a debt. In addition to the **level** of assets, the **composition** of assets is also crucial. A household needs to make an educated decision about types of assets, taking into account such characteristics as liquidity, level of risk, rate of return, tax treatment, and the extent of knowledge and time that assets management may require. Furthermore, the level and mix of asset ownership of all households is directly related to the overall functioning of the economy. Understanding household asset ownership behavior does in part influence the economic climate in which households will operate in the future.

Hira's 1987 study describes the types and amounts of assets owned by households; it also indicates sociodemographic characteristics that influence the households' asset ownership. The research also examines the relationship between selected money management practices and the asset ownership behavior of the household.

A majority of the households (60 to 70 percent) owned assets like current accounts, savings accounts, automobiles, homes, cash value life insurance, and certificates of deposit. A smaller proportion (30 percent or less) reported investments in mutual funds, stocks and bonds, and retirement accounts. Mean value of assets for the sample in the study was \$107,273. Age, income, and home ownership were among the sociodemographic characteristics that were significantly related to the size of assets owned by a household. Money

management practices that significantly affected asset ownership included the amount the respondent felt comfortable owing and number of credit cards.

According to the results of this study, most households invested in conventional types of assets such as savings accounts, certificates of deposit, cash value life insurance policies, and real estate. This finding raises the question of why households are **not** selecting mutual funds and IRAs for their investment choices. Mutual funds are believed to be an appropriate vehicle for most investors since they provide the diversification and services of a professional manager at an affordable price. IRAs provide an opportunity to plan for retirement and reduce tax liability at the same time. People are either uncomfortable or uninformed about these investments. These findings are of some value in particular to both educators in the personal finance area and financial institutions selling these products.

Recommendations

1. Personal finance courses, specifically emphasizing areas such as consumer debt, credit card management, savings, and risk management, should be developed. These courses should be part of the educational curriculum starting at junior high level.
2. More research examining the financial knowledge of students attending other universities besides Iowa State University is needed. Beyond just knowledge, data is also needed on financial management practices and attitudes of students.
3. More research is needed that investigates the causal relationships among knowledge of credit, attitudes toward credit, and credit practices.
4. The ultimate objective of all efforts (educational and otherwise) is to

increase families' level of economic well-being and their satisfaction with various aspects of their overall financial situation. Research results identify younger and larger households, renters, and single individuals as particularly able to benefit from money management education. The results also indicate that greater emphasis should be placed on teaching topics related to consumer credit and particularly topics related to credit card management.

5. Emphasis should also be placed on the importance of savings. Money managers whose households reported saving some portion of their family income were more satisfied with their overall financial situation, better able to handle use of credit and borrowed money, and were solvent.

Impact of Financial Problems on Families

The impact of financial problems on families has been studied by researchers over the last few decades. These studies can be divided into two areas: 1) consumer bankruptcy studies and 2) those studies that have focused on stress and conflict caused by financial problems.

The number of people resorting to bankruptcy has been consistently on the increase. There appears to be a number of factors causing bankruptcy, most of which can be grouped into three categories: 1) personal problems, 2) employment problems, and 3) credit and financial problems.

Slightly less than half (42 percent) of debtors in bankruptcy identified marital problems as a factor leading to their bankruptcy. Child support and alimony problems were identified by 22 percent of the debtors. Medical bills as a cause of bankruptcy was reported by 39 percent of the debtors who had experienced bankruptcy. Unemployment per se was indicated by 24 percent of

respondents as an important cause of bankruptcy. Approximately 48 percent of the respondents identified credit problems as a leading factor in their decision to declare bankruptcy.

Researchers have found that decisions about borrowing depend on whether individuals think their current income can support another monthly payment, not on the total cost of a purchase, and the size of their debts in relation to their income or assets.

Based on the results of several studies, one can conclude that a debtor in bankruptcy is usually an employed male who is in his thirties, works in a blue collar occupation, has 10 to 12 years of education, and earns on the average \$14,620 in income. Bankrupts are usually married and have young families. However, trends in consumer bankruptcy are such that the proportion of females, white collar workers, middle-income, highly educated, and older (40+ years old) persons among those declaring bankruptcy has been increasing (Hira and Mugenda, 1987).

Many researchers have surveyed individuals who have experienced bankruptcy. According to the results of these studies, it appears that the majority of respondents indicate they have changed their money management practices. For example, they have stopped using credit, started paying their bills on time, started developing spending plans, and stopped carrying credit cards. Several studies stress that a major cause of bankruptcy is the inability of consumers to manage their credit use effectively. It has been found that discharged bankrupts still lack credit knowledge. Many of the bankrupts who were interviewed were afraid to handle credit after declaring bankruptcy.

Empirical studies indicate that stress and conflict caused by financial problems can have detrimental effects on individuals within the family and on

family relationships. Several researchers have found a correlation between financial stress and problems such as mental illness, suicide, heart and kidney disease, stroke, violent behavior, and depression. Investigators have also found an association between various forms of family violence and specific stressful conditions such as unemployment and financial problems. The highest incidence and most severe cases of child abuse occur when the family is facing unemployment. Solving the family's money problem can alleviate some of the stress and disharmony within the family. The association between money problems and stress within families indicates the need to address financial problems when designing programs to support families and improve the quality of family life (Ulrichson and Hira, 1985).

Recommendations

Agencies and organizations committed to helping families need to be aware of the impact of financial problems. Efforts made by different agencies and support groups may be organized in the following three directions:

1. Presenting holistic programs which include both financial and family counseling.
2. Targeting the populations in need of assistance, specifically the young, middle income families, and female-headed families.
3. Coordinating efforts of support groups within the community and finding vehicles to get the support to those in need.

Implications for Educators and Researchers

The 1980's have brought consumers the benefits of many new products and services, but this has also made the decision-making process regarding the selection of these products and services a complex task. The various choices present many conveniences and opportunities to seek higher returns. However, each option has different risks attached to it; and the appropriateness of each depends upon the differing goals and various stages of the family lifecycle. For the consumers of these products and services, confusion is caused by all of these choices, creating a need for better understanding of the whole area of personal financial management. Educators and researchers have been presented with the challenge to engage in research and to develop teaching materials and programs in areas of concerns.

Recommendations for educators

1. Content of traditional financial management coursework and Extension programs must be reassessed. Educators will need to move beyond mere descriptions of financial products and the institutions in which they are sold. Personal finances courses should emphasize skills that enable consumers to evaluate the information regarding various products and services that is forced upon consumers from various sources.

2. Decision-making models that can be used to assimilate information, to evaluate alternatives, and to consider short- and long-term consequences of choices should become an integral part of education. Consumers should be taught an appreciation of the dynamics and complexity of markets.

3. Adult education programs should help the public expand their "comfort zones" with regard to electronic delivery of financial products and services. Such "hands on" experiences should be targeted to the middle-aged and older population. This market segment did not grow up with electronic toys or computers and has been accustomed to buying financial products in a face-to-face setting.

Recommendations for researchers

Hira and Fletcher (1985) have described several areas of research that are needed to provide a basis for educational programs, information systems, and policy recommendations. Specifically, research is needed:

1. To identify the impact of products and methods of delivery.
2. To assess information systems that can provide clear, credible, and timely information to help consumers understand and function effectively.
3. To identify specific changes or enhancements which would make products and services more consumer-sensitive. For example, in an electronic environment, consumers need improved record-keeping and documentation capabilities.
4. To assess the need for regulation of a deregulated industry. Policy issues still being debated are privacy, security, and information disclosure. Should policy be legislated or adopted as a voluntary code?
5. To identify needs and problems of special consumer groups, e.g. various income, age, and physically disabled groups and those individuals who are slow to adopt to advanced technologies.

Senator DODD. Thank you for that. And any of that additional data or information you have, we will make it a part of the record, as people review it in looking at the legislation. But we thank you very much. And I've got some questions, but we will wait to get through with all of the witnesses here.

Dr. Hogarth, we welcome you to the committee.

**STATEMENT JEANNE HOGARTH, Ph.D., ASSISTANT PROFESSOR,
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Dr. HOGARTH. Thank you for inviting me to meet with you today. Although I am here from the Department of Consumer Economics and Housing, New York State College of Human Ecology, Cornell University, I need to say that I am here representing myself, and the information and opinions I offer are those of myself and not of Cornell University. [Laughter.]

Senator DODD. We have never had disclaimers like that right off the bat.

Dr. HOGARTH. The attorney told me to say that.

Senator DODD. The attorney told you to say that. [Laughter.]

Your attorney or Cornell's told you?

Dr. HOGARTH. Cornell's.

Senator DODD. Yes. [Laughter.]

Dr. HOGARTH. I would like to share with you a quote from Ellen Webb, who wrote in a November 1984 Newsweek:

As a consumer, I am not delighted by the cornucopia of goods and services available to me. Instead, I am angry that I can't begin to make a systematic comparison and, thus, a rational choice. And so I buy haphazardly, as other consumers must do.

We could replace Ms. Webb's cornucopia of goods and services with the cornucopia of bank accounts and not really diminish her sense of frustration. Walking into his or her local bank, today's consumer faces a myriad of financial products and services. I work with the Ellen Webb's of this world.

One was a 60-year-old, middle manager in an Upstate New York plant who was offered an early retirement incentive. In deciding whether or not he could accept the incentive, we looked at his assets, which included a house, a vacation cottage and \$50,000 in a passbook savings account. Real estate and passbook savings accounts. Those are the only kinds of assets he and his family could understand.

Or take the case of a single-parent, low-income household, who with some basic budgeting education, was able to save a few dollars a week toward her children's school clothes, but no bank in town offered a free savings account for such low balances. What was she to do?

The simple passbook account has dozens of permutations. Checking accounts may or may not pay interest, and the fee structure can range from free to monthly service fees, plus per check and per deposit charges.

Certificates of deposit can have interest rates, based on various combinations of principals and maturities. These rates can be indexed in Standard & Poor's 500 Stock Index, the Treasury Bill rate, the prime rate, the annual increase in college costs or the price of

gold. And these rates may not reflect the actual rate of return, since some may have up front fees.

Turning to credit products, consumers are faced with choosing among fixed and adjustable consumer and mortgage loans, between credit cards with and without floats, between credit and debit cards. And in addition to interest rates, consumers must also factor in the numerous fees associated with many credit and loan agreements. While working through these decisions, consumers must also consider the tax consequences of each of these savings and credit options.

One response to this overchoice is to do nothing. According to Federal Reserve Board figures, there are over \$400 billion in pass-book savings accounts. We know that retired households hold between one-half and two-thirds of their financial assets in savings accounts, hardly the way to buffer retirement income against the effects of inflation.

CONSUMERS ARE CONFUSED BY MANY CHOICES

We could make the case that some of this money is in these lower earning accounts, because consumers are confused by the choice in the market and have done nothing.

Some may be aware that they could be earning higher interest rates, but they perceive the time costs in gathering information from the local financial market and transaction costs in moving their funds, to be too high.

Consumer economists want to believe that consumers optimize income, including interest income. Clearly, leaving money in pass-book accounts seem contrary to this optimization process; however, income can be both intrinsic and extrinsic. Intrinsic income is from a variety of sources, and that includes peace of mind. If consumers feel more comfortable with the money in passbook accounts, and they have consciously chosen to leave their savings in these accounts, then they probably are optimizing their combination of extrinsic and intrinsic income.

It is important to know the difference between consumers who do nothing and consumers who actively choose to do nothing.

While additional information may cause the active consumer to change his or her mind and reach a different optimum, more information may only add to the confusion of other consumers. Additionally, as an educator, I have observed that bringing consumers and information together is no easy task. For example, in a survey of retirement-aged New York State employees, 77 percent indicated the desire for more information on financial management and planning alternatives for retirement; however, only 17 percent had been to any retirement planning workshop or seminar, even though several work site opportunities were available, and they had release time for them.

The availability of information at the appropriate time at a teachable moment is important. Information needs to be on line and ready, as consumers need it.

Making the fruits of electronic technology available to a wide range of consumers, via financial data bases and public use terminals would benefit consumers. And consumers must know their in-

formation resources within their communities, be it financial institutions, public libraries, the Cooperative Extensive System or other agencies and organizations. Even when consumers do seek out information, it is not always available in consistent format. Interest rate information on credit products has been standardized; however, the fee structure and grace periods are not always clearly specified in terms consumers can understand. Thus, consumers may not be choosing the best credit alternative.

Interest rate information on savings products is currently not standardized at the national level, although some States, like New York, have truth-in-savings legislation for State-chartered banks.

Without truth in savings, consumers are put in the situation of needing to calculate effective annual yields in order to make accurate comparisons. Standard rate information would help these consumers choose among various institutions and accounts.

Shopping for interest is only one part of the story, however. Terms used in conjunction with interest rates can take on a variety of meanings. The term "minimum balance," for example, can mean many different things.

Nor is information always reliable. For example, in 1982, a reporter for the Wall Street Journal surveyed five branches of one particular thrift institution. No one single branch was able to provide him with a full listing of accounts available, which he finally received from a senior vice-president of the institution.

While this may be possible for a reporter's assignment, it is unlikely that the average consumer will be as tenacious or will have access to senior officers of institutions.

BANK EMPLOYEES NEED TRAINING TO GUIDE CONSUMERS

Bank employees need training and need to be furnished with the resources necessary to answer consumer information requests. More information does not necessarily lead to better financial management decisions. Consumers need not only information, but also decision-making skills and tools to process information in a meaningful way and relate it to their personal circumstances.

The rules of thumb which used to work no longer apply. For example, it used to be the time deposits had higher interest rates than demand deposits, but in some banks today, it's possible to get a higher rate on a passbook account than on a CD.

New rules of thumb and decision tools are needed. There are numerous examples of public and private sector agencies working to bring the consumer and information together and to assist the consumers in developing decision-making skills.

For example, the New York State Banking Department and Cornell Cooperative Extension have teamed up to produce a video tape and teaching guide on team financial account choices for use in high school classes.

The banking department supported the production and costs and supplied all high schools in the State with a copy of the materials.

Cornell Cooperative Extension provided the subject matter and educational process expertise and offered teacher training on the use of the materials in a variety of high school subject matter areas.

With the skills learned from these materials, the next generation of consumers will be better equipped to make choices in the financial market. Support for such efforts needs to continue.

In addition to the formal and informal education networks operating via the schools and the cooperative extension system, there are other agencies and organizations working to inform and educate the consumer.

The Federal Reserve Board survey of bank rates is often published in many newspapers. The College for Financial Planning, American Express, Consumers Union, the Consumer Federation of America and American Association of Retired Persons are a few of many involved in disseminating information to consumers.

United States consumers are very diverse in age, income, access to financial markets and their relative needs for financial management and planning information. For example, explicit pricing of banking services has removed many account alternatives and choices from low income households. Yet, these households need access to basic banking services, such as simple transaction accounts, in order to safely and efficiently handle their money.

In some cases, these basic lifeline accounts require that consumers use statement savings instead of passbook savings in ATM's for transactions.

For the low income elderly, this arrangement could be problematic, since they are more likely to prefer in person tellers and passbook accounts.

In summary, I think it's important to remember that we are discussing a heterogeneous market with heterogeneous customers in an ever-changing economic climate.

Consumers need a variety of choices in financial accounts since their needs will vary with their circumstances. Thus, responses to consumers' use can encompass a wide range of informational and educational programs in schools, communities and institutions which will empower individuals and families to adjust to personal and marketplace changes.

Thank you.

[The complete prepared statement of Jeanne M. Hogarth, Ph.D., follows:]

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CONSUMER CHOICES IN THE FINANCIAL SERVICES INDUSTRY

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INTRODUCTION

"As a consumer, I am not delighted by the cornucopia of goods available to me. Instead I am angry that I can't begin to make a systematic comparison and thus a rational choice. And so I buy haphazardly, as other consumers must do."¹ This is one response to choice overload in the financial services market; another response is to do nothing. Consumers need help in sorting through the available choices and in applying decision making skills to narrow their choice set.

Although most consumer groups will find it difficult to sort through financial choices, the elderly seem to have particular problems in relating to financial markets today. This paper focuses on some of the issues regarding consumer financial account choices and family financial decision making with particular emphasis on elderly consumers.

"THE ELDERLY"

First, it is important to recognize that the elderly are not a homogeneous group. Depending on the definition used, they can range in age from the "young-old" (the 55 year old retiree) to the "old-old" (the 90 year old still living independently). The socioeconomic characteristics of households with an elderly member can vary considerably. For example, in 1983 Survey of Consumer Finances, half of retired households had a net worth of over \$43,200; however this ranged from \$55,000 for those aged 55 to 64 down to \$35,000 for those age 75 and over (see Table 1). Considering financial assets only, the median value of holdings of "elderly" households ranges from \$8,700 to \$11,400.

Expenditure patterns of "the elderly" differ also. Older households spend larger proportions of their income on food, shelter, and health expenses (see Table 2). They also tend to consume more of their total income, leaving little, if any, for saving.

In addition to having different levels of financial resources to draw upon, "the elderly" have different sets of values and varying levels of comfort with regard to the technology that has evolved in the financial services industry. For example, we know that the older-elderly are more likely to prefer in-person tellers to automatic teller machines and to prefer passbook savings accounts to statement savings accounts. Whether the current young-old will continue to embrace technology and use ATMs when they are 80 or 90 is not certain.

INVESTMENT AND CREDIT CHOICES Changes in the Financial Services Industry

Changes in the financial services industry have been both continuous and expansive. Spurred by general economic conditions, deregulation and electronic systems, daily (or even hourly) changes are possible. Innovations have resulted in an ever expanding choice set of financial products for households. Deregulation has enabled banks, thrifts, brokerage houses, and insurance firms to offer literally hundreds of financial products and services, from the usual savings and checking accounts to all-inclusive asset and cash management accounts.

New savings products include a wider variety of certificates of deposit (CDs), including "designer CDs" which can be scheduled to mature when a tuition or tax bill is due and college-savings oriented CDs with interest rates indexed to the annual average increase in tuition, fees, room and board at a composite of 500 colleges and universities. Other CDs have interest rates linked to the Standard and Poors 500-stock index, to the price of gold, to Treasury bill rates, and to the prime rate. The potentially higher interest rates are offset by the risk of low or zero interest should the index not perform as savers expect.

Credit products include traditional fixed rate as well as adjustable rate consumer and mortgage loans. While second mortgages are not new credit products, the tax consequences of home equity loans (versus consumer loans) have given rise to additional promotion of home equity loans by banks. Most banks actively promote revolving credit via bank credit cards and many have debit cards as well.

While expanded product lines owe much to deregulation, technology has also played a role. Electronic networks enable financial institutions to gather and update information continually on economic conditions and financial markets world-wide. Using this information, institutions can make their products and services more immediately responsive to the current economic climate through the use of variable rate credit and investment products.

Investment products which pay market rates have caused a change in the fee structure of many financial institutions. Gone are the days of "free" checking and free low-balance savings accounts. Households now may have to pay for checking and some savings accounts or keep relatively high balances in these accounts for "free" services. A survey of Albany, New York banks in 1984 revealed that some banks required as much as \$200 in a savings account to avoid service fees and as much as \$500 in a checking account for free services.² Several banks have no "free" checking accounts, regardless of the balance. Fees on other services (overdrafts, stop payments, safe deposit) have risen, but in turn households may be receiving higher rates of interest on other deposit accounts.

Implications for Consumers

The presence of an ever expanding choice set of savings, investment, and credit alternatives may spur some households to more efficient and effective financial management decision making. But these abundance of choices may overwhelm a great number of families. Despite the availability of "market rate" accounts, nearly \$413 billion remains in regular savings accounts. These balances are very different in nature than they were 10 years ago; in 1977, the turnover rate of money in savings accounts was 1.5; in 1987 it is estimated to be 4.2 while for checking accounts the rate is 21.0.

The large amounts of savings held in passbook accounts in some ways reflects the consumers' confusion regarding all the choices. For example, if even 25 percent of the money in passbook accounts earning 5.5 percent were placed in short term CDs earning 6 percent, there would be a net gain of \$55 million in interest to households.

The change in the interest rate structure on many investment products has changed the "rules of thumb" that consumers can use. In "the old days" before deregulation, it was safe to assume that time deposits (CDs) paid higher interest rates than passbook accounts. Now, some banks offer CDs at rates lower than their passbook accounts, depending on the principal and maturity. This implies that consumers must spend considerable time shopping for the best combination of principal, interest rate, compounding period, and maturity and process that information in order to make appropriate choices with regard to financial accounts. Availability of information in a usable form can be problematic; this issue will be addressed later in this paper.

While retirement nest eggs should not be considered venture capital, there is room for retired household to improve asset management and thus increase income from asset resources. For example, data from the 1969-79 Longitudinal Retirement History Survey shows that retired households tend to increase the proportion of assets held in savings accounts over their retirements (see Table 3).³ Moving some of these assets into other low risk investments with higher rates of return would generate more income for these households and improve (or maintain) their economic well being.

A study by Jensen and Chen determined that low proportions of the elderly made use of some of the newer products and services offered by financial institutions. As age increased, the proportion of households using interest bearing checking accounts and money market accounts declined.⁴ A large proportion of the elderly used direct deposit services, but few used deposit by mail or ATM services (see Table 4).

The same study found that the elderly were also more likely to over estimate savings rates and underestimate loan rates. The implication is that they could benefit greatly from gathering

information and shopping for the best combination of interest rate and maturity. However, the perceived transaction costs apparently outweigh the perceived benefits. Jensen and Chen found that older consumers remained tied strongly to an institution for checking and savings accounts. The average "age" of checking and savings accounts for their sample of elderly was 20 years; over half of those age 75 and over had a checking account with the same institution for more than 25 years.

Variable rate investment and credit instruments pose complex problems for family financial management. Households facing variable rates on consumer or mortgage loans must be able to plan ahead to cover potentially rising interest expenses. Variable rate loans may result in higher monthly payments or payback over a longer term. Both require careful consideration of ways in which households plan and manage their finances.

Variable rate investments require more frequent decisions on the part of the saver/investor. For example, a retiree who wishes to live off the interest generated from his/her retirement nest egg may have to make more decisions if that sum is invested in a variable rate instrument, especially when market rates fluctuate over short periods of time.

The changing fee structure in banks and thrifts may price some bank accounts and services out of the reach of low income and elderly households. Provision of "lifeline" transaction accounts is one response to assist these households.

ACCESS TO INFORMATION Information and Decision Making

We are an information-based society. Financial information can come from a variety of print and media sources; but timely, up-to-the-minute financial information relies on technology.

The consumer with access to videotext services such as CompuServe, The Source, or Dow Jones News Retrieval, can call up interest rates on CDs from banks across the country and make a decision on which to purchase based on a wide range of information. Credit interest rates from a wide variety of sources are also available to these families, as are the latest stock, bond, and financial market quotes. These consumers are able to maximize investment income and minimize credit costs. Consumers without access to such information must spend much more time on the telephone or reading newspaper advertisements seeking information, and they are not likely to search a wide geographic area. They are also less likely to get the "best" rates for either investments or loans.

Computers can become important tools not only in seeking but also in analyzing and processing that information. Software programs exist to help consumers plan investments,

anticipate the tax consequences of particular financial decision, and choose among credit instruments, whether consumer or mortgage loans. Spreadsheet programs enable consumers to ask the "what if" questions: What if we pay off this loan in three years instead of four? What if we invest in company X instead of Y? Electronic checkbook programs can help families track expenses and provide summary information in clear and concise formats to help consumers make current and future financial decisions.

Implications for Consumers

In the instances cited above, more information is equated with "better" decisions, which may or may not be the case. Consumers need not only information but also decision making skills and tools to process information in a meaningful way and to relate it to their personal circumstances to lead to improved economic well being.

Availability and access to information is a concern for many consumers. "Up-to-the-minute" information sources, such as videotext, require costly subscriptions and analytical computer programs can cost hundreds of dollars. It is probable that those with greater financial resources are more likely to have access to and use these information sources, further expanding their financial resources. Consumers with fewer resources may have less access to information and necessarily would make more poorly informed decisions. To a degree, information gaps would act to widen any financial resource gaps within society.

This does not have to be the case. Public use videotext terminals can provide timely information, including that of financial account options, to those unable to afford private subscriptions. The Prestel system in Britain and GrassRoots Canada are two such examples.

Communities may want to develop public use computer facilities. Public libraries or schools often serve as sites for such facilities. Coupled with a library of software, people who cannot afford their own personal computer can still take advantage of the analytical powers of computers to help them in financial decision making.

Consumers often express an interest in obtaining more information for decision making, but often they do not make use of available information sources. For example, in a survey of retirement aged New York State employees, 77 percent indicated a desire for more information on financial management and planning alternatives for retirement. However, only 17% had been to any retirement planning workshop or seminar, even though several worksite opportunities were available.⁵ Bringing people and information together at a teachable moment is no easy task.

One alternative to information- and choice-overload is to hire a service which will sift through and process the information and choices available and offer a more restricted choice set.

In many cases, this service is provided by financial advisors who charge an hourly fee or work on commission from the sale of products offered in conjunction with advice. However, the consumer often is in a poor position to judge the quality of the advice, short of understanding the credentials of the financial adviser. Many states are exploring the possibility of registering financial planners and advisers in the hopes that minimum educational and experiential requirements will assure some basic level of quality.

ADDRESSING THE ISSUES

Many consumer issues benefit from a three-prong approach to problem resolution: consumer education and information, voluntary compliance, and legislation and regulation. While legislative and industry responses are possible, the discussion below will focus on consumer education and information responses.

It is clear that consumers need, and want, more information to help them make appropriate financial account and service choices. It is also clear that bringing the consumer and the information together can be problematic. Timing is important; it is necessary to identify teachable moments when the need for the information and the availability of the information coincide. This means that information must be "on line" and ready as consumers need it, and that consumers need to know their information resources. One suggestion mentioned above is access to public use videotext terminals with financial services information, located in public libraries or county Cooperative Extension offices.

Print resources also can be made available to consumers. Many newspapers publish information on savings and credit interest rates on a weekly basis in conjunction with the Federal Reserve Board's consumer information survey of banks. However, interest rate information is only a partial response. It seems that many consumers do not understand the various types of accounts available and need help identifying the advantages and disadvantages of different accounts for their situation. Print information in the form of flyers or fact sheets may be useful.

It is important to remember, in the case of the elderly or others with sight problems, or for low literacy consumers, that printed resources may need supplementation by audio resources. For example, pre-recorded dial-in phone information lines or audio tapes could be used to assist the visually impaired.

There are numerous examples of public and private sector agencies working together to bring the consumer and the information together. For example, the New York State Banking Department and Cornell Cooperative Extension have teamed up to produce a videotape and teaching guide on

Senator Dodd. Thank you very much, Dr. Hogarth.

Dr. Phelps, we welcome you. You're very patient. Thank you very much.

Just use that microphone, if you would. I'm sorry there are only two of them there, so when you get to the questions, you'll have to pass this back and forth to our recorder here.

**STATEMENT OF DR. KERMIT PHELPS, CHAIRMAN OF THE BOARD,
AMERICAN ASSOCIATION OF RETIRED PERSONS, WASHINGTON,
DC**

Dr. PHELPS. On behalf of the more than 27 million members of the American Association of Retired Persons [AARP], I wish to thank Chairman Dodd and the members of the Consumer Affairs Subcommittee for holding this hearing on the ability of consumers to plan their financial affairs.

AARP is delighted to participate today and stands ready to assist the committee in securing the passage of S. 1507 and S. 616 during this session of Congress.

CONSUMERS MUST PLAY CATCH-UP

Business as usual for the financial services industry has changed rather dramatically in recent years. Consumers must now play catch-up in order to keep abreast of the rapidly changing marketplace.

Enactment of enhanced disclosure legislation like S. 1507 and S. 616 is necessary to ensure that everyone will benefit from the new financial services environment.

AARP believes that only a relative handful of people are actually reaping maximum benefits under the present system. This point was illustrated in the results of a national telephone survey conducted for AARP by Hamilton and staff in December 1985.

When responding to the question: Do you find that choosing bank accounts and other services is more confusing or less confusing than it was 5 years ago, the results were 49 percent felt more confused; 35 percent less confused; and 16 percent had no opinion.

While almost half reported more confusion, interestingly, the young, the highly educated, the more highly paid and those with upper white collar jobs were more likely to acknowledge confusion than the old, the less educated, the poor and the unskilled.

These latter groups were more likely to say they do not have an opinion on this question, nor on questions requiring specific knowledge throughout the survey.

This leads us to the conclusion that many people simply don't know how much they don't know about today's financial services environment.

In addition, the problem does not seem to center around particular types of services or transactions; rather, since many products and offerings are new, we believe there is a general lack of sophistication and knowledge concerning all types of financial service products.

This problem is particularly acute for older women who are not aware that financial service decisions should be reevaluated, or are

unfamiliar with making financial purchase decisions, or wish to defer to decisions made by a now-deceased spouse.

Because of this, AARP recently developed a Women's Financial Information Program, which offers information on a variety of financial service matters, including credit, banking, insurance, housing, end-of-life matters, social security, pensions, and general planning for the future.

This program consists of a series of financially oriented seminars covering different topics over a 7-week period.

The first seminar, conducted in Little Rock, AR, drew more than 340 registrants. Turnouts in other locations throughout the country have also been strong.

CONSUMER EDUCATION DESPERATELY NEEDED

While consumer education is desperately needed, Federal legislation is necessary to make sure that all essential information is available to consumers when they need it, so that more meaningful decisions can be made.

Conditions and prices of deposit accounts have changed rapidly in recent years. Consumers are now faced with a widening array of account options; for most consumers, the expansion of account offerings has not been matched by information necessary to compare varying accounts, or to make prudent financial purchase decisions.

S. 1507, the Truth-in-Savings Act, requires the disclosure in each advertisement, announcement or solicitation for interest-bearing accounts of annual yields, their effective periods, minimum balance requirements and any other terms or conditions that may affect consumer costs.

In addition, schedules detailing certain components for all accounts routinely offered by institutions must be readily available to the public and written in a legible and readable format.

Both of the types of disclosures mentioned above—advertisements and schedules—are directly responsive to the needs of consumers for accurate, complete, up-to-date and uniform information.

The Truth-in-Lending Act currently requires disclosure of credit card pricing information prior to the first transaction on the card. Thus, many consumers may have already received their cards and paid the annual fee before such requirement disclosures are made.

S. 616, Full Credit Disclosure Act, requires the disclosure of annual interest rate, annual fee, the method of calculating the balance and the availability of a grace period in any credit card application or solicitation.

AARP supports the need for credit card disclosure before the application is completed. We believe such disclosures are essential to enable consumers, particularly older consumers, to compare different terms and conditions of various credit card offerings. Such upfront disclosures should result in more meaningful consumer purchase decisions.

AARP appreciates this opportunity to participate. And we look forward to working with the members of the committee toward the speedy markup of S. 1507 and S. 616 during this session of Congress.

Requests have been made of AARP concerning the present elderly population and future trends. We have a packet here called, "A Profile of Older Americans," which we wish to distribute here and to have entered in the record.

Thank you very much.

[The complete prepared statement of Kermit Phelps, Ph.D., follows:]



STATEMENT

OF

THE AMERICAN ASSOCIATION OF RETIRED PERSONS

ON

NEED FOR ENHANCED CONSUMER INFORMATION
CONCERNING FINANCIAL SERVICE MATTERS

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS

OF THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

NOVEMBER 5, 1987

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John T. Denning *President* Jack Carlson *Executive Director*

Introduction

On behalf of the more than 27 million members of the American Association of Retired Persons (AARP), I wish to thank Chairman Dodd and the members of the Consumer Affairs Subcommittee for holding this hearing on the ability of consumers to plan their financial affairs. AARP is delighted to participate today and stands ready to assist the committee in securing passage of S. 1507 and S. 616 during this session of Congress.

Background

The deregulation of interest rates was begun in 1979 and completed March 31, 1986. While deregulation has increased competition, it has also created confusion with the vast array of new financial service products presently on the market. Indeed, financial institutions are offering a wide variety of services, often with tiered charges or fees, at variable interest rates with complicated compounding procedures. Many institutions are charging for formerly free services and increasing charges for services they have traditionally offered for nominal fees. Initial deposit and minimum balance requirements as well as numerous other terms and conditions on accounts are prevalent. The proliferation of credit cards has increased purchasing convenience, but at costs to consumers.

Business as usual for the financial services industry has changed rather dramatically in a relatively short period of time. Consumers must now play catch-up in order to keep abreast in a rapidly changing marketplace. Enactment of enhanced disclosure legislation like S. 1507 and S. 616 is necessary to ensure that everyone will benefit from the new financial services environment.

AARP believes that only a relative handful of people are actually reaping maximum benefits under the present system. This point was illustrated in the results of national telephone survey conducted for AARP by Hamilton & Staff in December 1985. When responding to the question, "Do you find that choosing bank accounts and other services is more confusing, or less confusing, than it was 5 years ago?", the results were:

- 49% - more confused
- 35% - less confused
- 16% - no opinion

While almost half reported more confusion, interestingly the young, the highly-educated, the more highly-paid, and those with upper white collar jobs were more likely to acknowledge confusion than the old, the less-educated, the poor and the unskilled. These latter groups were more likely to say they do not have an opinion both to this question and to questions requiring specific knowledge throughout the survey. This leads us to the conclusion that many people simply don't know how much they don't know about today's financial services environment.

In addition, the problem does not seem to center around particular types of services or transactions. Rather, since most products and offerings are new, we believe there is a general lack of sophistication and knowledge concerning all types of financial service products. While consumer education is desperately needed, federal legislation is necessary to make sure that all essential information is available to consumers, when they need it, so that more meaningful purchase decisions can be made.

Account Disclosures

Conditions and prices of deposit accounts have changed dramatically in recent years. Consumers are now faced with a widening array of account options. For most consumers, the expansion of account offerings has not been matched by information necessary to compare varying accounts or to make prudent financial purchase decisions. This problem is particularly acute for older women living alone, who are not aware that financial service decisions should be re-evaluated, are unfamiliar with making financial purchase decisions, or wish to defer to decisions made by a now-deceased spouse.

S. 1507, the Truth-In-Savings Act, requires the disclosure--in each advertisement, announcement or solicitation for interest bearing accounts--of annual yields, their effective periods, minimum balance requirements, and any other terms or conditions that may affect consumer cost. In addition, schedules detailing certain components for all accounts routinely offered by institutions must be readily available to the public, and written in a legible and readable format.

Both of the types of disclosures mentioned above--advertisements and schedules--are directly responsive to the needs of consumers for accurate, complete, up-to-date, and uniform information.

Credit Card Disclosures

Truth-In-Lending currently requires disclosure of credit card pricing information prior to the first transaction on the card. Thus, many consumers may have already received their cards and paid the annual fee before such required disclosures are made.

S. 616 requires the disclosure of the annual interest rate, annual fee, the method of calculating the balance, and the availability of a grace period in any credit card application or solicitation.

AARP supports the need for credit card disclosures before the application is completed. We believe such disclosures are essential to enable consumers, particularly older consumers, to compare differing terms and conditions of various credit card offerings. Such up-front disclosures should result in more meaningful consumer purchase decisions.

Conclusion

AARP appreciates this opportunity to participate. We look forward to working with the members of the committee towards speedy mark-up of S. 1507 and S. 616 during this session of Congress.

Thank you.

Senator DODD. Thank you, Dr. Phelps, very much for your testimony and we'll see that one of those brochures is made a part of the record, as well.

Let me—I'll address some questions to you, but for the sake of gathering as much information, any question I ask, if anyone wants to comment as well, even though I've addressed it to one of you, if you feel as though you would like to add something to it, please step right in.

A couple of suggestions. I think, Dr. Stephenson, you made a suggestion regarding education, levels of education. And I forget which—Dr. Hogarth, or you, Dr. Hira, who also commented on the importance in our school systems. One level is junior high school. Others have suggested getting down even to the elementary school level.

What could you possibly be teaching an elementary school student about financial services? What would you recommend?

Dr. STEPHENSON. Well, we do some of that in our 4H Clubs and the Cooperative Extension Service when we start with 8-year olds and teach them how to count money, how to save money, how to share money and, in other words, make a loan to somebody else and get it back.

There are a number of ways that you can do that. And you could build it right in, I would think, to the curriculum without having a separate course in the money management.

Senator DODD. Dr. Hira.

THRIVING ON PLASTIC PROSPERITY

Dr. HIRA. I would suggest two topics. One is the area of savings. I think we could start the students at a very young age to even save part of their pocket money and put it aside for a goal, short-term, within 1 week, within 2 weeks, within a month. Something that they really want to have; because I think it's sad to see the children grow up thinking that the credit cards are money, or we can go to the store and get things without recognizing the relationship with what you have to pay.

The importance of recognizing that if you want to have item A, the price may be that I can't have item B, or if I want to have item B, I can't have item C, or some sort of that thinking can occur at a very, very early age.

And I think we grow up probably to a point where we are really thriving on this plastic prosperity without having any relationship with what our resources are and what our returns are.

We have things that we can't afford, quite frankly.

Senator DODD. We're all guilty of that, I think, at one point or another. [Laughter.]

Senator DODD. Yes, Dr. Phelps.

Dr. PHELPS. Seems to me that the education should be also directed toward the parents, because as long as they're going to serve as models and are going to have that before the children, they're going to follow along.

I think one of the ways in which you can really get them to recognize what kind of a system they live in is to have them to try to develop a corporation on their own and see whether it can make

teen financial account choices, "You're Accountable," for use in high school classrooms. The NYS Banking Department supported the production costs and supplied all high schools in the state with a copy of the materials. Cornell Cooperative Extension provided the subject matter and educational process expertise, and offered training on the use of the video in a variety of high school subject matter areas. Similar projects for elementary school aged children and senior citizens are being considered.

While more information in appropriate formats is important, it is perhaps even more important to help consumers learn and develop appropriate decision making skills to help them sort and process the information they have and to implement decisions. Across the U.S., county Cooperative Extension System agents, supported by specialists at the land grant colleges, provide non-biased, research based educational materials for consumers. Many of these materials assist consumers in developing the decision making skills necessary to cope with the wide range of changes and choices in the financial market.

CONCLUSION

A number of factors, including technology, deregulation, economic conditions, have enabled the financial services industry to change and adapt its products, services, and delivery of those products and services, creating a wider choice set of investment and credit instruments and a wider range of services for families. Access to information using various technologies will change the ways consumers get and use information to make financial decisions.

Consumers can use technology to improve their financial management and decision making, but there are still some issues which must be recognized and addressed by policy makers and educators. Among these are the questions of access to information, changed financial management behaviors resulting from institutions' and consumers' use of technology, and the stresses which some consumers will face as they struggle to meet rising variable rate loan payments. Some economic groups will have less access to technology; yet they will be affected by the services that certain technologies provide. Their particular financial management needs must also be addressed. As in many cases, there seem to be no easy solutions, only difficult questions.

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Table 1
Ownership of Selected Assets
Median Amount and Percent Holding

Asset	Head Retired		Age 55 to 64		Age 65 and over	
	\$	%	\$	%	\$	%
Checking account	\$ 900	78	\$ 995	83	\$ 987	80
Savings account	2,188	50	1,588	58	2,412	53
Money Market account	11,156	6	7,400	18	11,156	18
Certificate of deposit	19,392	34	12,255	30	19,892	37
IRA or Keogh	4,000	8	4,000	33	6,000	8
Savings bonds	800	15	750	21	846	14
Stocks	10,000	20	7,250	25	10,150	21
Bonds	17,500	4	12,500	5	20,500	4
Tax exempt bonds	13,740	5	17,500	5	21,932	5
Property (exc. owned house)	11,000	19	40,000	30	40,000	20
Business	97,500	7	55,000	12	83,202	7
Total Financial Assets	8,747		9,338		11,400*	
					10,350**	
Net Worth	43,213		55,587		50,181*	
					35,939**	

Source: Survey of Consumer Finances. The Table reads: Seventy eight percent of households with a retired head held checking accounts; the median balance in these accounts was \$900.

Note: The Survey of Consumer Finances over sampled wealthier households; thus these figures have a slightly upward bias and may not represent the total population of persons 55 and over in the U.S.

* Age 65-74

** Age 75 and over

Table 2
Expenditure Patterns of Households with
an Elderly Member
(given in percentages)

Expense Category	Age 55-64	Age 65-74	Age 75 and over
Food	13.5%	16.1%	16.5%
Housing Shelter	12.0	14.5	16.7
Utilities	7.0	8.9	10.9
Other	4.1	5.0	6.1
Clothing	4.3	4.1	2.9
Transportation			
Car	7.8	6.9	5.9
Gas & oil	4.1	4.3	3.2
Other	5.8	6.6	5.2
Health	4.7	8.5	12.3
Contributions	4.4	4.6	10.7
Insurance			
Personal	1.4	1.3	.7
Retirement	7.8	3.2	1.4
Entertainment	3.8	3.6	2.6
Other*	4.6	4.7	4.3
Proportion of income consumed by above expenditures	86.4%	93.4%	100.3%
Average income in 1985	\$27,055	\$18,191	\$12,306

Source: 1985 Consumer Expenditure Survey. The table reads: On average, households with a head aged 55 to 64 spent about 13.5 percent of income on food.

*Other items include personal care, reading materials, education, tobacco, and miscellaneous items.

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Table 3
Retirement Asset Portfolios over Time
(in percentages)

	At Retirement (1971)		8 Years Later (1979)	
	w/House	w/o House	w/House	w/o House
Savings				
Accounts	28.3%	49.3%	34.8%	66.1%
Checking				
Accounts	4.6	8.2	3.8	6.6
Savings				
Bonds	3.2	4.7	1.8	2.6
Stocks and				
Bonds	6.5	8.5	5.6	7.8
Life				
Insurance	18.2	29.3	9.8	16.9
House	39.2		44.2	
Median				
Value	\$33,342	\$15,107	\$50,103	\$18,528

Source: Longitudinal Retirement History Survey. The table reads:
Excluding the value of owned housing in the asset portfolio, retired
households held about half (49%) of their assets in savings accounts at
the onset of retirement. Eight years later, they held about two-thirds
(66%) of assets in savings accounts.

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Table 4
Account and Service Use by Age
(in percentages)

Account or Service	Total	55-64	65-74	75 and over	
Regular checking	71.9%	74.4%	77.4%	64.1%	
Regular saving	66.1	83.7	64.2	59.4	
Interest bearing checking	28.1	37.2	29.2	23.4	
Money market	35.3	37.2	41.5	23.4	
Certificate of deposit	34.4	41.9	35.8	29.7	
Direct deposit	54.5	55.0	57.6	46.8	
Mail in deposit	15.2	16.2	14.9	14.6	
ATM use	10.8	18.0	11.4	3.7	
Estimated savings interest	6.0	6.09	5.95	6.06	Actual = 5.5%
Estimated credit interest	14.39	14.68	14.39	13.72	Actual = 15.0%

Source: Jensen and Chen. The table reads: Nearly 72% of households age
55 and over had a regular saving account; the percent of households
with a savings account ranged from 64% of those aged 75 and over to 77%
of those aged 65 to 74.

money and they can save it, which you have in the junior achievement programs.

Senator DODD. One suggestion that occurred to me is that a lot of times there is homework, and it's home and parental work—student/parent work. So that the problem-solving involves the parent or parents being involved in the question.

And it occurred to me this may be a perfect area, where the work must be completed by both the student and the parent, if you will. So that the parents don't want to admit that they don't understand these things.

We're all, I think, a little shy about admitting how little we know about financial services. And we also have to wait to be invited. I love that club member since 1976, on TV, the American Express ads, as if it were some sort of exclusive country club you were joining. I'm particularly glad that you, Dr. Phelps, are here today on behalf of AARP. And that you, Dr. Hogarth, talked about the elderly.

Today there is the changing consumer, with all the demographics and sociological changes in our society which has made this issue increasingly complex. I think we're all aware of it, how the family, the American family is changing, the number of women in the workforce. Today, over the last several years, people have had more money, less time. Certainly, my generation.

And so they're anxious to complete their financial services all at one time. They don't have the opportunity to go to the bank, go to the insurance company, go to the real estate broker. I mean, they'd kind of like to have one-stop shopping, in effect, with financial services to the extent they can.

But, also, as that changes, there are an awful lot of people who are not a product of that, who are retired, or who are completely out of touch with this computer age. And I notice some banks, for instance, have coffee and doughnuts. And it's designed because a lot of elderly people, it's a social occasion to go to the bank. They don't get a chance to go out very often. And banks are beginning to realize that if they maintain tellers—I think there was one bank that eliminated tellers, unless you had accounts in excess of \$5,000. And they dropped it very quickly because it was an utter disaster.

But that notion that while we are speeding things up, making things easier, ATM's and the like, there is a need, it seems to me, among elderly Americans or older Americans, to want to feel still very comfortable with a system that they grew up with.

And these changes are really frightening to many of them.

Is that a fair assessment, do you think?

There are other examples where the banks have tried other things, like getting rid of tellers, and so forth. Do you know any banks which have tried those tactics?

Dr. HOGARTH. Not that I'm aware of. In my testimony, in the printed documentation that I've presented to you, there's some wonderful evidence by Helen Jenson and Wynn Chen that look at how the elderly use financial services.

And you can see that they're less likely to move their money around. They're less likely to use new accounts.

There's one wonderful statistic that said that, on average, people who are 75 years and over have had the same bank for 25 years.

Senator DODD. Yes.

Dr. HOGARTH. And there's just this tremendous tie to the marble and brick and, you know, wonderful people that they see there. And that's not bad.

Senator DODD. No.

Dr. STEPHENSON. And in working in that Chen and Jenson study, it was interesting to find that the elderly really did not want to give up their passbook for statement savings. They felt comfortable having that passbook when they would go in the bank. So it's hard to make those changes.

Senator DODD. Yes, that's true.

Dr. Hira, in one of your studies, you concluded that people with a higher score knowledge indicators felt comfortable owing more money on credit cards and also had a larger number of cards.

Is that correct? Have I heard you correctly?

Dr. HIRA. Yes.

Senator DODD. I wonder if you might suggest whether or not there's a correlation between knowledge and proper use of credit cards, or just between knowledge and use—or abuse of credit cards.

Dr. HIRA. I think one thing it indicates is that, of course, people who are highly educated, I mean more years of schooling, and have high-paying jobs are the ones who will get more cards. They have more access to the cards as compared to blue collar population that is—who would have lower income, lower schooling.

So that is one reason. The other reason is we are talking here about the use of the card, which in itself is not a bad thing, which means the use of the card for convenience purposes.

I think the real issue is how many users are paying finance charges and how many of them are not paying.

LOWER INCOME PEOPLE PAYING MORE FINANCE CHARGES

Our research findings say that it's the lower income people and lower education people who are the ones who are paying more frequently finance charges.

Senator DODD. Yes.

Dr. HIRA. So I think yes, it is. Actually, one of the real issues that needs more clarification is relationship between credit knowledge and credit use. Does the knowledge come after experience in using or is it more knowledgeable people use more cards.

So I would suggest that we do need to do a little bit more research. The body of knowledge is very limited to base some of our policies and recommendations and education programs on that research. The research is rather limited.

But, if I were to go further, I would explore that point a lot more.

Senator DODD. Well, economists will generally tell you, I mean, there's some disagreement, but that credit cards have been good for the economy. That it strengthens the economy. And this shouldn't be—I know you don't. I don't think any of you argue with—

Dr. HIRA. It's true that by allowing people to spend more than what they had, they were able to spend in that point of time, we expanded the economy. We allowed more production, and we al-

lowed people to own the items like car and home if the credit wasn't there.

Senator DODD. And then the fact that you don't have to pay it necessarily in many cases right away.

Dr. HIRA. Right. I think that's not the point. I think that is good. But what's bad is, when we move to buy items such as food, generally going out and eating, the food is consumed immediately and the payments are still to be made at a high cost like 19 to 20 percent, I think that's where we get into trouble.

So I think that's where the prosperity actually ends. And I think that's not adding to the economy.

But I think the cost of this type of credit use is to the individual and the families very, very high.

Senator DODD. Yes. But the question I wanted to get at, and I know, in Japan, for instance, they have credit cards. But there you must pay every month. You're not allowed to string that out over 12 months. Yet, no one would disagree they have a strong economy.

Dr. HIRA. Right.

Senator DODD. What is the—how would you explain that?

Dr. HIRA. I think that is a good answer for the economists, who say that the only way to expand the economy is to allow people to borrow the money. I think, because—

Senator DODD. I don't think they say it's the only way.

Dr. HIRA. We have—

[Laughter.]

Dr. HIRA. That is the way because we see—I think one of the ways that the economy gets stronger is by increasing savings. And in Japan, we do have a savings rate that is very high that allows the expansion of the economy rather than going through the borrowing.

And again they are using the borrowed money to extend themselves, but within a time period where they have to pay it back.

Senator DODD. Well, how do they encourage that? I mean, it isn't—

Dr. HIRA. Well, I think more than encouragement it is legislated. The banks are not allowed to go on with the minimum payments and use cards as a revolving account.

Senator DODD. No, I know that. I'm talking about the savings.

Dr. HIRA. Savings? Some of the social programs that we have are not there. Some of the retirement, such as social security, is not as strong and well-developed as we have it. I think people have to provide for their own well-being more than what we in this country do. We have some cushions that, again, maybe not knowing enough, we think that it will come through when we need it, which is nonexistent particularly in that country.

And I think people realize that they have to save for themselves. At least, that's my ignorant assessment by observing what I observed while I was studying there.

SHEPHERD PROGRAMS

Senator DODD. There are special consumer groups, the handicapped comes to mind, and other people who are in the work force

who are mentally retarded, but certainly competent of being self-sufficient, and so forth.

Are there specific things we might be thinking about in that area at all rather than just the general consumer? There are a growing number of people who are deinstitutionalized and the like, people out on the streets who are retarded a bit, but, nonetheless, are capable of being self-sufficient, on their own.

To what extent should we be trying to talk about things that might be done that would be beneficial to groups like that? Or should we even bother?

Dr. HOGARTH. Well, that's an economic decision, obviously. There are some alternatives. Certainly, for the physically handicapped, where actual physical access to banking is a problem, we know that there's electronic banking, there's home banking.

And just as we have TTD units for the deaf, we can, you know, set up home banking units for the physically handicapped.

People who are developmentally delayed, that becomes problematic; understandably, if I were a banker, I would be concerned about, you know, being forced to have lifeline accounts for people who may not understand the concept of being overdrawn on a checking account.

But, I think that there are—I want to call them shepherd programs. Many of the utilities have these, where they have somebody kind of watching out for you. And it may very well be possible to adapt some of those models to banking services as well.

Senator DODD. Anyone else have any comment on that?

[No response.]

Senator DODD. No?

You mentioned in your testimony about \$413 billion in regular savings accounts that the people have. I mentioned in my opening remarks that there were only a few years ago these noninterest-bearing accounts.

Do you have any idea at all how much money still exists in those? That people are holding on to the passbook saving? How much is sitting in those kinds of accounts around the country?

Dr. HOGARTH. I honestly do not know. I can tell you that while 70 percent of the elderly have checking accounts, only 29 percent of the elderly have interest-bearing checking accounts.

So it seems to me that, again, a large chunk of that money is sitting in noninterest-bearing accounts.

Senator DODD. It would be interesting to find that out.

Dr. HOGARTH. I'm sure the Federal Reserve Board would have that data from the latest survey of Consumer Finances. There's a 1983 and a 1986 follow-up survey.

Senator DODD. I'll try and get that.

Certainly, interest rates have declined. We all know that. The amounts still being kept in low-yielding accounts, however, would seem to support your conclusion of consumer confusion, which really does exist.

We're considering, as I mentioned, truth in savings legislation. That would require disclosure of such items as annual percentage yield, minimum balance requirements, a statement of the regular fees, other conditions that could reduce the yield, and a statement that an interest penalty is required for early withdrawal.

Let me ask you all this, these several questions, if I could. And I gather by your statements you would indicate yes in the first, but I wonder if you might—sometimes, so much disclosure is confusing.

In the credit card legislation, and other legislation that we're working on, shows how difficult just reading the stuff can be. I'm losing my eyesight I think slowly with some of this stuff. It's just a foul-up.

But just the number of things that we tell consumers can just turn off a consumer, I think. There's just so much to read, you read nothing.

And I wonder if you might share with me just some of your thoughts on what you think are the most important items for disclosure, whether or not you agree. I mean, I presume too much disclosure on these things is of little utility, while it may be beneficial if you could read it all and understand it, would it be helpful?

WHAT DOES THE CONSUMER NEED TO KNOW?

But what are the key items people ought to know when you're talking about a truth in savings kind of legislation? What does a consumer really need to know, in your mind?

Start anywhere.

Dr. STEPHENSON. I think they need to know the true annual yield. But, probably as important as that, they need to know the method of calculation of that interest rate.

Senator DODD. Well, I mean, that's a pretty confusing thing to understand.

Dr. STEPHENSON. Yes, it is. But it makes a big difference as to how much you're going to earn on that interest.

Senator DODD. Are they really going to understand that?

Dr. STEPHENSON. I would hope so. I don't know why it couldn't be presented in such a way if you laid it out that they could understand that.

We're back to education again. I don't know that you hand that out when somebody takes out—opens an account. I don't know that that's possible.

Can you educate like that in a bank?

Senator DODD. I don't know. I mean, Peter Kinzler a few days ago showed me—this is my chief staff guy in the Banking Committee—showed me—what was it?—a home equity loan application. And we sat there for an hour looking at that thing. And I'll be darned if—I even called the place, and they couldn't explain it either. I mean, there were numbers there that just were there.

And even with that, it was very confusing to follow.

Dr. STEPHENSON. Well, I asked if you could do it in a bank. I think, in many banks, they wouldn't want to do it because it would point to the fact that they were not paying what another bank was paying.

So, again, it would have to be legislated, I think.

Dr. PHELPS. I think it would have to be translated into some common language. How much am I going to get from this kind of investment, so that I will have so much more next year than I have now.

Dr. HOGARTH. I think it's important to keep this in perspective. Going back to the Survey of Consumer Finances, one of my favorites, the primary criteria for choosing an institution is convenience.

Secondary criteria, all lumped up there right around 20 percent each, safety availability of multiple services, low service fees. Deposit interest rates come in a really pretty distant third.

That's not to say, it doesn't matter. I think it does. But I think you also need to keep it in perspective and say that consumers are not going to move their money around a lot. They're going to choose a bank because it's on the corner on the way to work, on the way from work. They perceive it to be safe; it has reasonable fees.

Maybe the regulation should be on fee structure more than on interest rates.

Senator DODD. Dr. Phelps.

Dr. PHELPS. Well, even the elderly at the present time are quite mobile. And where at one time you went to a particular bank because of its location, its assessability, they sometimes—well, not sometimes, but very frequently get moved even though they don't want to be moved—I'm talking about the elderly themselves—because somebody else makes that decision.

And, consequently, the kind of stability that you got from things not changing is no longer with them.

Senator DODD. That's a good point, good observation.

We also, the credit card legislation, which I think we'll be moving along pretty quickly in here now that the House has acted on it, I think you've all commented on it. But, do you think we have—have we covered enough in that in the disclosure, in your own views? Or are there things you would add, or subtract? Any of you?

Did you all have a chance to look at that? Any comments on it at all, Dr. Hira?

Dr. HIRA. I think it looks good. I think now really the challenge we have on our side is to make people aware of what it is that they should be looking for.

And I think I just want to take a step back again to your point that I think the work that is being done with legislation and the regulation is very, very crucial.

On the other hand, I think we often need to bring people along to make them conscious of the things that they should be looking for.

I would like to give you a little example on the point that we just discussed about how people selected financial institutions.

One of the assignments and one of the classes at the lower level—102 on the level on family finance was to look at so many—five different places for the saving account and five different places for the checking account.

And we gave them a list of items that the students should use to compare different institutions.

And then it was very interesting to see that after that exercise how many of them decided to change their accounts. The reason that we did it that way was because they really didn't know what were the bases on which they should be comparing the accounts.

So my point is this, that somewhere along the line, we need to bring them along from a very simple level of knowledge to a sophisticated level to cope with a complicated market.

They don't now because we have never brought them along with us.

Senator DODD. Yes.

Dr. HIRA. I think that is one of the reasons that I, again, will emphasize the need for education to bring them along with what is happening with us at all levels—the market and the legislation and the regulations are moving forward very speedily, whereas, the consumers are not moving along speedily to be at the same level.

Senator DODD. Yes, that's true in so many areas, but this particularly.

STUDENT DEFAULT RATE

You mentioned that someone did student loans. I happened to catch this morning one of the morning programs. There was a mini-debate between an official from the Department of Education and the president of a college out in Chicago. The Department of Education is thinking about penalizing the educational institution where you have rates of default above a certain level. I forget what the level was they were talking about.

But, some institutions apparently have default rates. Not institutions, but students at certain institutions, as high as 50 percent of the students who are on student loan programs.

And one of the suggestions was—I don't know if they're thinking of legislation or not, but that at the time that the institution might spend more time with students explaining what their financial obligations are going to be as a result of that.

And it seemed like a sound idea. I'm surprised there isn't more of it. Why don't you comment?

Dr. HIRA. I'd like to point out to you that I was just sharing it with my colleagues here, that we at Iowa State University have just developed a master's program, which is a student financial and services management program.

And the purpose of that is exactly the same that we—feel people employed in this should be specially trained in financial counseling and money management areas to prepare students to develop a program to pay their loans regularly.

I think when students borrow money for education, that is one of the teachable moments; and young students are willing to learn money management skills.

Senator DODD. Is it required that they do it?

Dr. HIRA. No, no, no, it's not required. It's a program that was developed and financial aid office at ISU voluntarily agreed to participate.

Senator DODD. Yes. It seems to me, I mean, just to require even an hour.

Dr. HIRA. That is my point, where I will draw the parallel between bankruptcy procedures, too. I don't understand why wouldn't there be something that is part of the bankruptcy process where we encourage people to attend five sessions in credit management, or whatever it is that they do before they're discharged;

because what is the guarantee that they are going out tomorrow and they know how to do it better?

The thing that we've learned from the bankruptcy studies is that they're scared. Well, that's not what we want to do. They're scared of credit. And you just said, that, yes, credit is an integral part of our economy. It does good things to us. But we need to teach people how to manage it well so it does do what is started to do.

Senator DODD. Well, part of the problem is I should know more about with the reforms of the bankruptcy law. But you can't take the bankruptcy act for quite a while after you take it once.

So at least it wasn't—

Dr. HIRA. Well, you can't for 7 years, or something like that. But—

Senator DODD. It's difficult to get credit, I presume.

Dr. HIRA. Well, you can get it right next day. I mean, that's no problem.

Senator DODD. No, it's a good risk because the person can't go bankrupt again for 7 years. [Laughter.]

They seek them out. I think the credit card companies are hanging out outside those bankruptcy courts lining up people.

Dr. HIRA. Well, that should be something that should be discouraged, too, somehow or other because I really think we haven't—I think there are some areas where we can incorporate the teaching part, force people to learn if they are not interested in learning by themselves. Make it a requirement. If they are going to be given freedom from their debts, maybe they ought to learn so that it doesn't happen to them tomorrow.

Senator DODD. But I think it really highlights the point. I mean, I don't know what the economic or the educational level would be. It would be interesting to know what the educational level of your average bankrupt is.

Dr. HIRA. I think the thing that we have seen has been about, oh, 12-14 years.

Senator DODD. More than a high school education?

Dr. HIRA. Yes. Yes. And the level of education is increasing though. I mean, if you see the last 5 year studies, the level is going up.

Senator DODD. Yes, that doesn't surprise me. And it sort of strengthens your point that, if it's a problem there, it's certainly a problem all the way down.

Dr. HIRA. I also think that we have to stop and think where the learning occurs. It occurs from the role models. It occurs at the formal training. It occurs from the experience. And I think the only way most of the people learn is through experience. So we default before we learn because the role models aren't appropriate; they were in a different environment than we are.

Senator DODD. Well, I could carry on this conversation with you all afternoon. I really am enjoying it. As I said, this is really our first swing at this a little bit, but I gather, if I could draw any conclusions from your testimony, you do think there's a Federal role here. We could do some things that will be helpful.

And we'll be looking forward to working closely with you on some specific ideas and suggestions, the educational front in schools. I sit on the Labor and Human Resources Committee and

chair this Subcommittee on Families and Children. And I've held many hearings on the effects of child abuse and alcoholism, and children of alcoholics, and the like.

Boy, you just run into it all the time—where financial difficulties, unemployment, obviously is a major—you can chart unemployment lines and child abuse and alcoholism and, you know, they just overlap each other.

But also just financial difficulties, aside from unemployment, the kind of frustrations that that creates in families. It really is alarming. So it's more than just a question of someone handling their checking account properly. We're constantly changing the rules and making it even more confusing, I think, along the way.

So, hopefully, we'll reach a point of some stability here with some clear guidelines.

But I thank you for being so patient. I apologize again for being a little late starting, and look forward to working with you over the next—

Dr. HIRA. But I do want to comment. I think our country has actually a much more higher level of regulations and care and concern for the consumers than anywhere in the world.

So, I know we have a lot to do, but I also would like to remind ourselves that we have done well.

Senator DODD. I'll make sure that's a part of the record of this Consumer Affairs Subcommittee. There aren't many of those around the world. [Laughter.]

I don't think Mr. Gorbachev has a Consumer Affairs Subcommittee. [Laughter.]

Our next witness is Dr. Mitchell.

Doctor, you have been very patient for waiting. We hope it's been helpful for you to hear some of our comments.

Senator DODD. We are pleased to hear your statement, Mr. Mitchell.

STATEMENT OF JEREMY MITCHELL, PROJECT DIRECTOR, BASIC BANKING SERVICES PROJECT, PROVIDENCE, RI

Mr. MITCHELL. Thank you. I am Jeremy Mitchell, and until 1986 I had been executive director of the British National Consumer Council for the previous 10 years. I now work independently as a policy adviser to consumer organizations, especially on banking and financial services policy and legislation.

I have just finished editing a book on money and the consumer, an international consumer view of the financial services revolution. I would like to make my own personal contribution to the resolution of your budget deficit problem by not asking for this to be included in the record. [Laughter.]

Senator DODD. There will be an article in the Hartford papers tomorrow, with the price tag on it.

Mr. MITCHELL. The book is the outcome of a joint United States-British-European symposium of consumer leaders that was organized by the British Money Management Council and supported by American Express Co.

I should explain that I am currently carrying out a study of basic lifeline banking services for low-income consumers in the United

States, funded by American Express Foundation. However, my views are entirely my own.

I would like to be very brief and just bring five issues to your attention: constraints on consumers' access to the banking system; the cost of credit to consumers; privacy of consumers' financial affairs; the need for improved consumer information; and alternative dispute resolution procedures when a consumer has a complaint against a bank or other financial services institution.

CLOSURE OF BANK BRANCHES

First, access: The closure of bank branches means a minority of consumers are finding it increasingly difficult to get to a bank at all. There are reports of branch closures, particularly in some rural and inner-city areas.

The statistics are interesting. In 1984, 865 bank branches were closed down in the States compared with only 248 in 1980. So the pace of bank branch closure is increasing, and the opening of new branches in the prosperous suburbs is absolutely no compensation for those consumers that are left without a banking facility.

Other consumers are being denied access by the explicit pricing strategies that are being adopted by the banks since deregulation. The proportion of families without any kind of savings or checking account rose from 9 percent to 12 percent between 1977 and 1983, according to Federal Reserve Board research. That increase was particularly marked among low-income families.

If you take the bottom 20 percent in terms of income distribution among families, the proportion without a savings or checking account rose from 28 percent to 36 percent over that 6-year period. And it's not surprising, because, as the Consumer Federation of America research shows, the average cost of running a little-used checking account that is only used relatively infrequently now comes out at about \$90 per year. So that is a significant deterrent for low-income consumers.

Now, that basic lifeline banking services issue remains largely unresolved, with the banking industry claiming that low-cost checking accounts are widely available and consumer and community organizations contesting this and saying that even where such basic no-frills checking accounts are available, the banks do little to promote or explain them to low-income consumers.

There is a very interesting example of a California bank, Bank of the West, which has introduced a basic checking account which in all respects except one is a very good one for consumers.

The one fault it has is that it is pushing them toward the use of automated tellers, and every time they go into a branch of Bank of the West, the holders of this basic banking account, they are charged a dollar every time they talk to somebody on the staff.

Well, these are just the people who need the advice and the help of the bank staff, and they are being penalized financially in this basic banking account. So that kind of strategy of pushing low-income consumers toward automated tellers and electronic banking is not one that is helpful to that section of the community.

It is certainly a fundamental principle on the consumer side that denial of access to the banking system—whatever form it takes,

whether it's geographical or financial—effectively shuts out those consumers concerned from an important form of participation in modern economic life and from a significant source of advice and information. And there is certainly an element of public utility provision in banking services, and banks should not ignore this in their search for profitability.

MASSIVE INCREASE IN CONSUMER CREDIT

The second issue, borrowing: The major shift that is occurring here in the States and worldwide is, as we have already heard today, a massive increase in the use of consumer credit of all kinds.

Again citing the Federal Reserve Board research, consumer installment debt—that is, nonhousing installment debt—rose from \$337 billion in 1983 to \$552 billion in 1986. That is a rate of interest of 18 percent per annum compound, and that represents a new high not only in absolute terms but also relative to consumers' disposable income.

While in principle, of course, credit can be very beneficial to consumers, but it is currently being promoted and marketed very, very heavily, and consumer attitudes haven't yet caught up with the abundant availability of credit. There is still a feeling that if a bank or another financial services institution gives me a loan, they are doing me a favor, rather than the other way around, which is how it is today.

What is surprising, I think, is that the cost of consumer credit, especially the credit card interest rates, remain so high despite this abundant availability. The law of supply and demand seems to have been suspended and the free market is not operating as it should.

Now, this is something which consumer organizations here are confronting with their fight-and-switch campaign on credit cards, and I suggest it's an issue worthy of serious study. It's difficult to believe that credit card interest rates averaging around 17 percent per annum reflect the true costs of this kind of credit. Something has gone wrong with the marketplace.

PRINCIPLE OF CONSUMER PRIVACY

The third issue, privacy, I think is probably somewhat outside the scope of these hearings, so I will deal with it very briefly.

The principle of privacy in the consumer's relationship with his or her financial services institution is very highly valued by consumers. However, it is increasingly coming under threat from computerization of personal financial files which makes it much easier to aggregate and retrieve and transfer consumers' personal financial data; and also from the emergence of financial services conglomerates. These can use the personal financial data they get from their banking services activities to promote other marketing purposes.

I can give you an example from over the water, from Britain. One of our major banks, Midland Bank, owns a travel agency, Thomas Cooke, a very large travel agency. Now, Midland Bank has just issued to all its personal customers new terms and conditions which effectively allow it to transfer their personal financial data

from the bank company to the travel agent. That is, to my mind, a total infringement of the consumer's relationship with his or her banking institution, and it is the sort of thing that is going to increase with the emergence of financial services conglomerates.

IMPROVED CONSUMER INFORMATION

The fourth point, the need for improved consumer information: There are a number of studies here, for example, by Consumer Federation of America and the attorney general of the State of New York which show how confusing and inconsistent banks are in using concepts and terms which consumers need to be clear about.

An example—and I think it was mentioned before in previous testimony—is the minimum balance the consumer has to keep in the account to avoid service charges. Now, this is interpreted in a wide variety of ways by different banks. It may be the balance at the beginning of the accounting period. It may be the average balance throughout the accounting period. It may be the balance at the end of the accounting period. There is absolutely no consistency in the way that phrase is interpreted, and there certainly seems to be a clear need for improved consumer terminology, a standardization of the terminology as far as consumers are concerned.

There is also a need for better comparative information for consumers about fees and terms and conditions of different accounts and financial services. There has been excellent work by bodies like Consumer Federation of America and Consumer Action of California. But this is really not as widely known here as it ought to be.

The ideal would be some kind of financial services consumers association which would collect and publish such information, not necessarily in written form. It might be on an online computerized basis for consumers. But I must confess that at present I don't find it easy to see how such an association would be financed.

HANDLING CONSUMER DISPUTES

The fifth point, there is a need for a quick, inexpensive, informal, cheap procedure for handling consumer disputes with banks and other financial institutions. It is not practicable for consumers to go to law over a dispute involving, say, \$50 or \$100 with a bank.

If again I can refer to British experience, 4 years ago, when I was director of the National Consumer Council, we recommended that a banking ombudsman should be appointed to deal with individual consumer complaints. And this has gone ahead. We now have a banking ombudsman who is, in effect, an arbitrator empowered to make an award of up to the equivalent of \$80,000 against a bank in relation to any individual consumer complaint. This is all done with the agreement and participation of all the banks in Britain.

The value of this system to consumers comes not just from the ombudsman's judgments but from the way the banks have sharpened up. They have improved their internal procedures for handling consumer complaints.

Senator DODD. Has it also increased complaints?

Mr. MITCHELL. There has been an increase in complaints, I am delighted to say. [Laughter.]

Senator DODD. If we have nothing else to do today, let's see if we can hit the jackpot.

Mr. MITCHELL. The complaints were suppressed before because it just wasn't practicable for the consumer to seek redress in the courts against a bank. So I view in the short run the increase in complaints as a positive sign.

Finally, while it would be inappropriate for me as a foreigner to make any general comments on how well the U.S. banking system serves its consumers, may I very briefly mention three ways in which I think that services here are lagging some way behind those in Britain and Europe.

Now, first, the cashing of Government checks. This is absolutely no problem for those without a bank account in Britain and Europe, as Government checks can be cashed at post offices. There is absolutely no problem in Britain and Europe.

Second, some form of electronic banking are much more highly developed on the other side of the Atlantic. Electronic funds transfer at point of sale is well established as a working national system in France, and it's in an advanced stage of experiments and development in other countries.

The same applies to home banking. In France there is the video text-based Minitel system. In Britain two major banks are launching telephone home banking with a special keypad you can attach to your telephone.

Also, consumer organizations increasingly are using electronic information systems about banking services for their members. The Belgian consumer organization uses on- and off-line computerized information systems for its members to give them advice on the best mortgage available and so on.

The third and final point is on the internationalization of financial services, which is going ahead rapidly. The European Economic Community, the Common Market, has set a target for removing all barriers to mutual trade in financial services among its 12 member countries by 1992. And just 2 weeks ago the European Payment Systems Council announced that by 1992 all credit and debit cards in the whole of Europe would be fully interchangeable at all terminals in all financial institutions from Norway and Finland in the north to Greece, Portugal, and Italy in the south.

Now, sometimes to those of us coming to this country from overseas, it seems as though this land which stretches from the redwood forest to the New York island is a world of its own. But I don't see how the globalization of financial services can be ignored. It is happening elsewhere at enormous speed. It is going to present consumers with opportunities, but with enormous problems of choice because it will be a choice not only among the institutions and the services in one country but an international choice that they will have to make.

It may be that a German insurance company or a British insurance company will offer a better deal, or the British consumer will get a better deal on a bank account from an American company. That period is, I believe, coming much faster than we all realize.

[The complete prepared statement of Jeremy Mitchell follows:]

TESTIMONY OF MR. JEREMY MITCHELL.

This memo essentially represents the testimony of Mr. Jeremy Mitchell, who edited the American Express Conference Report on Money Management. Because we spoke with him on such short notice, he was not able to write a prepared statement. This is a summary of an international consumer symposium sponsored by The American Express Company and the Money Management Council, a personal finance education organization based in the U.K. Thirty-five representatives from eight countries assembled to discuss common problems in personal finance areas as a result of the worldwide revolution in the financial services.

There were five major areas of discussion.

1. ACCESS

A primary concern of the participants was universal access to financial services. Access in this respect encompassed everything from understanding and being able to use an ATM machine to comprehending documents before agreeing to the terms of a loan or investment. Another frequently discussed point was access to basic types of banking services for the low income, the elderly, and the handicapped, who may be less able to avail themselves to these services.

Understanding financial services is key to participating in modern life. Money matters have now become a normal part of the average consumer's life: credit, savings, insurance payments, and investments. These services clearly cannot be placed in the same category as other consumer goods, and yet have special features that require extra consideration in choosing and using.

2. CHOOSING

In the session on choosing, participants discussed the proliferation of financial instruments and services and the complexity often involved in seemingly simple selections. Product complexity reduces a consumers ability to make choices in his or her best interest, therefore having a negative effect on "market transparency."

3. BORROWING

The borrowing session focused a great deal on consumer indebtedness, the reasons for it, (including overzealous marketing practices) and solutions to the problem. Consumer indebtedness has been caused by many factors. In the U.S. contributing factors have been (1) the use of adjustable rate mortgages; (2) the proliferation of home equity loans; and (3) increased solicitation by credit card issuers.

4. PAYMENT

With the advent of ever-changing technology, the payment session focused on the effect of the electronic payment systems on consumers and their liability for transactions with these systems. It also questioned the privacy of information in an electronic environment.

5. REDRESS

Undoubtedly, with ready access to services, numerous choices in the marketplace, the increase of funds available to borrow, and advances in payment systems, confusion and differences of opinion will occur between consumers and financial institutions. The redress panel focused on allaying consumers' concerns in such circumstances.

Overall, the consumer voice is considered weak in the financial service industry in terms of influencing policy decisions or securing redress when problems occur. Participants agreed that redress should be independent, cheap, quick, and available to all; but there was by no means universal agreement as to the best method of achieving it.

6. "MARKET TRANSPARENCY"

The term is meant to be used in terms of a global marketplace where all terms and conditions in regard to financial products are the same, thus eliminating the problems which consumers have trying to compare terms and conditions. This concept is of particular interest now that the Subcommittee is looking into the some of the problems which colleges and other

programs are having in helping consumers to develop workable skills in this area.

ATTACHED ARE THE FINDINGS OF THE AMERICAN EXPRESS CONFERENCE.

FINDINGS

Tackling a number of international consumer issues, highlights of the symposium findings included:

- o The explosion of consumer credit in many countries has not lowered its cost for consumers. The group called for more consumer education. Reforms suggested to help curb consumer debt included tighter control of credit, the development of credit unions as a source of low-interest loans, lowering the cost of credit insurance, changes in entitlement programs and an increase in money advice centers.
- o Poor and lower-income individuals and families sometimes suffer exclusion and discrimination by financial institutions. Participants called enhanced access to financial services a universal necessity, imbuing the industry with the character of a public utility.
- o The proliferation and complexity of financial products reduces a customer's ability to make choices, therefore having a negative effect on market "transparency."
- o It was agreed that the legal rights of consumers in relation to new payments technology must be clarified and harmonized — especially the consumer's right to privacy and limits on liability for losses when a lost or stolen card is used fraudulently.
- o To strengthen the consumer voice in the financial services industry, financial services companies were urged to establish consumer affairs as a responsibility of an upper management officer.

Senator DODD. I couldn't agree with you more. Thank you so much for your testimony and for being here.

I am intrigued by the last part of your testimony because it is valuable to have someone with your experience, but also your interest in what goes on in other countries.

I think if you were to ask Americans what they thought of Americans as consumers, I think we would probably describe ourselves mildly as being assertive. And I suspect that Americans traveling in Europe, the people who ran retail outlets might use other words to describe the American consumer.

But I wonder if you might be able to say why is it in some ways? Are we talking cultural differences here? What is the reason you see for that?

We've heard the earlier testimony of Dr. Hira, who is still here—on why there is a higher degree of savings in Japan, arguing that there are less benefits, although I was under the impression that from cradle-to-grave sort of theory that many people use to describe what happens to the Japanese laborer with a lot of benefits along the way, a lot of protections, although that may not be the case.

Why is it? What is going on out there? How are we different, if there is really a difference? Or is something else going on?

POINTS OF DIFFERENCE IN FOREIGN AND U.S. BANKING

Mr. MITCHELL. Well, I think there are some points of difference and some of identity. The points of difference are in the structure of the banking system here and in the regulatory system that has been developed, which is quite different from that of other countries, and particularly your two-tier regulatory structure at the Federal level and State level of the banking system. That is a big difference.

I think there also have been historical differences where the culture of money in different countries, and particularly the different forms of payment used. This is quite noticeable, even among the European countries where consumers in one country rely heavily on checks which are hardly used in another country at all.

Credit cards, for example, have taken off in Britain almost to the same extent as the States. They are virtually unknown in Germany. It is an amazing puzzle to the credit card institutions why they cannot launch credit cards in Germany.

However, those are the differences. There are some points of identity where I think there are global trends which are tending to break down those differences.

First, the falling of barriers between different types of financial service institution, in Britain the distinction between banks and what we call building societies but you call thrifts, has virtually disappeared from the consumer point of view, both providing an identical range of services.

The insurance companies want to get into banking, the banks want to get into insurance. There is a sort of merging of the identity of different types of financial institutions. That is happening at different speeds in all countries. So that is one thing that is producing convergence between us all.

The second one is the new technology, and here again the ability to shift huge amounts of money around the world in a fraction of a second is something that no national frontier can actually resist.

I think those factors are leading to a convergence in our systems and to changes in consumer behavior. I think those tend to be much more long term than short term. But consumer behavior is changing.

Senator DODD. You heard me talk earlier about the questions and some of the comments on increasing consumer education of what is available to them today, how to distinguish and make intelligent consumer choices and the like.

I wonder if you have any ideas or suggestions on how we might do that. And are things done in some of the other countries such as your own to increase consumer education about what are the differences in the various financial services and so forth?

Mr. MITCHELL. I start off from the position of being extremely wary about consumer education because I have so often heard it used as a cop-out for getting to grips with a problem really effectively and also because consumer education is often least available to those who need it most. That is the real sort of "Catch-22" of consumer education. So that is my initial skepticism.

NO BANK INCENTIVE TO MARKET INFORMATION PROGRAMS

Having said that, I believe in this field that it is certainly possible for consumer education—or rather, let me change the word, if I may—consumer information to be enhanced and improved considerably. The problem is that there seems to be no market incentive for this. There doesn't seem to be any market incentive for the banks, for example, to engage in large-scale consumer information programs.

There are exceptions to this. I have seen here some very good examples of individual banks doing this. But generally there isn't the market incentive for them to do it, and that is one of the obstacles, I think, that is holding up the development of consumer information.

The problem with the educational institutions is that there are 147 different lobbies saying this kind of program ought to be introduced into the curriculum and financial services education has to fight for its pitch along with a whole host of other different programs trying to get included in any kind of formal educational context. And that is a very, very difficult job.

Senator DODD. Well, what would you suggest? You mentioned a couple of things, and we have discussed here periodically the notion of allowing or insisting that banks cash government checks. There have been some objections obviously raised about it.

One of the problems you point out is that—well, maybe you didn't point it out—is that we have governmental checks from various levels of Government, at the municipal, the State, and the Federal level, and whether or not you would allow all governmental checks to be dealt with in that way, there are some problems associated with that.

But serving that constituency, obviously, as you point out, the branches disappearing in cities and moving out to suburbs, mini-

mum balances that make it very difficult for people who unfortunately are not in the position where they can afford to keep a balance but merely want to keep what they have safe during the period of time that they use it.

I wonder if you have any suggestions on how we might guarantee and protect financial services for people who fall into that category that you have just described. Oftentimes better information doesn't make a whole lot of difference to them.

Mr. MITCHELL. I think there is one specific thing that could be done by the banks. In going around to the banks here and looking at their literature and talking to them, many of them—and the same is perfectly true in Britain and other countries—many of them make assumptions that consumers know how the banking system works, that they know what a check is.

Senator DODD. Who makes that assumption?

Mr. MITCHELL. The banks do.

Senator DODD. You don't really think that, do you? Do you think they really think that?

Mr. MITCHELL. Well, in their information programs there is very, very little material which actually explains to consumers how the account system works, what the differences are between different forms of accounts. There is actually a kind of assumption that the consumer starts off from a level of knowledge which I think among some groups in the community doesn't exist. This is in terms of looking and studying, looking at their literature and studying it.

I would suggest that the banks should not assume too much, that they might well have some very basic literature indeed which explains just what a bank account is, what advantages it offers, what the snags are, what the difficulties are, because many of the people outside the banking system at the moment—and the same is true internationally—they have, as it were, a basic mistrust and suspicion and they think the banks don't actually exist to serve them, they exist to serve the commercial community.

Senator DODD. Really, I happen to agree with you. I think that probably banks don't want that customer. That customer costs money. Just to handle an account, to open an account, to maintain an account—and if you are dealing with people who are not keeping balances in them but are merely just for cashing checks, what is the interest of attracting that consumer to come to your bank? Your pitch is to the consumer that is going to leave money there.

Mr. MITCHELL. Sure. Well, this is where I revert to what I said in my initial opening. That is that there is an element of public utility provision in what a bank should be doing. I don't want to over-stress that. Obviously, they are in business to make profits.

But nevertheless, they are chartered institutions that are operating in a sense with special privileges accorded to them by Federal and State legislation, and the trade-off for that is that is that they should exercise a sense of social responsibility particularly toward low-income groups in the community.

Now, it is very difficult to define exactly what that sense of public-responsibility, public-utility element should actually constitute. But I think it is up to the consumer organizations, the banks, and the legislators to thrash that out, try and define it more precisely.

It is not asking the banks to operate unprofitably but to say, "Recognize your social responsibilities. This is the minimum level at which these should be operationalized."

Senator DODD. Not that it's directly on point, but it's interesting that you suggest that, particularly coming from Great Britain.

We are confronted as legislators by arguments by the banking institutions all the time that we are so far behind the curve internationally that we are losing whatever advantage we may have had in the financial services market because of our burdensome regulatory process, among other things.

In fact, they oftentimes cite the British experience recently with regard to its financial institutions, the big-bang theory, and while it's different subject matters we're talking about, there is this notion that because we have constrained our institutions they are not as competitive.

Obviously, there is a lot of holes in that argument, but nonetheless that is the general thrust of it. One of the examples that is cited to us ad nauseam is the British experience.

BRITISH BANKS COMPLAIN ABOUT THEIR REGULATORY SYSTEM

Mr. MITCHELL. Well, I am sorry I can't expose you directly to the complaints that the British banks have about the British regulatory system. But they are vociferous in saying that they are over-regulated and citing examples from other countries of the greater freedom that they have.

I think we have much less of a formal regulatory structure than there is in the States. However, the informal regulation is very, very considerable through the central bank, the Bank of England. And because the Bank of England finds it very useful to use our banks as an instrument of monetary policy, then in exchange I think the banks are able to extract informal concessions from our central bank. It is a very, very different regulatory system.

Perhaps I can mention one point which specifically affects consumers and which is new in Britain, and it comes from our Financial Services Act, which was passed in 1986. That is, in terms of the range of financial services that a financial institution sells to consumers it has to opt either to sell its own financial products or else to act as an agent in the consumer's best interest. It is a principle which has been much debated over the past 2 years, and we call it the principle of polarization. And it was heavily fought against by the financial institutions, but it has finally gone through.

If you take our four major national banks, three have opted to sell their own financial products to their customers, one has opted for the path of saying, "We will act as agents for the consumer in scanning the market in the consumer's best interest and working on a commission basis without restricting the range of products available."

Now, that is an extremely interesting principle, and it does mean that consumers actually have much more clear knowledge when going to a financial institution of whether they are being sold financial products or whether that agent of institution is actually acting in their own interest.

It's too soon to say how this is going to work out in practice, but I thought you might be interested to know that that principle would very much affect consumers who want to put their money into securities and investments or into insurance. It's very interesting—and mutual funds as well, I should add.

Senator DODD. Well, it will be very interesting to observe and see how that works.

Mr. MITCHELL. Yes.

Senator DODD. We will keep an eye on that over here because certainly this is going to be the subject of major attention here over the next couple of years. So it will be interesting to monitor that.

You have been very kind and very patient as well in waiting this afternoon. I thank you for being here.

We will reconvene this committee on November 18, when we will, as I mentioned earlier, start to focus on some of the narrower questions of consumers, how consumers are affected in a changing market, the financial marketplace.

I thank all of our witnesses who were here, and this subcommittee will stand adjourned until further call of the Chair.

[Whereupon, at 5:40 p.m., the subcommittee was adjourned, to reconvene upon the call of the Chair.]

[Additional material supplied for the record follows:]

A PROFILE OF OLDER AMERICANS



1986

The Older Population

■ The older population—persons 65 years or older—numbered 28.5 million in 1985. They represented 12.0% of the U.S. population, about one in every eight Americans. The number of older Americans increased by 2.8 million or 11% since 1980, compared to an increase of 4% for the under-65 population.

■ In 1985, there were 17.0 million older women and 11.5 million older men, or a sex ratio of 147 women for every 100 men. The sex ratio increased with age, ranging from 122 for the 65-69 group to a high of 251 for persons 85 and older.

■ Since 1900, the percentage of Americans 65+ has tripled (4.1% in 1900 to 12.0% in 1985), and the number increased nine times (from 3.1 million to 28.5 million).

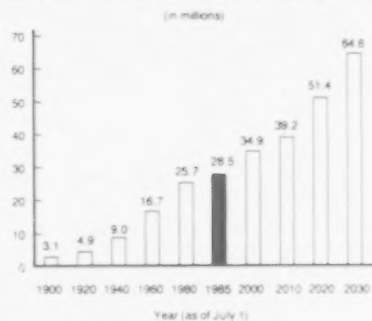
■ The older population itself is getting older. In 1985 the 65-74 age group (17.0 million) was nearly eight times larger than in 1900, but the 75-84 group (8.8 million) was 11 times larger and the 85+ group (2.7 million) was 22 times larger.

■ In 1985, persons reaching age 65 had an average life expectancy of an additional 16.8 years (18.6 years for females and 14.6 years for males).

■ A child born in 1985 could expect to live 74.7 years, about 27 years longer than a child born in 1900. The major part of this increase occurred because of reduced death rates for children and young adults. Life expectancy at age 65 increased by only 2.4 years between 1900 and 1960, but has increased by 2.5 years since 1960.

■ About 2.1 million persons celebrated their 65th birthday in 1985 (5,600 per day). In the same year, about 1.5 million persons 65 or older died, resulting in a net increase of over 560,000 (1,540 per day).

FIGURE 1
NUMBER OF PERSONS 65+ : 1900 to 2030



Note: Increments in years on horizontal scale are uneven.

Based on data from U.S. Bureau of the Census.

Future Growth

■ The older population is expected to continue to grow in the future (see fig. 1). This growth will slow somewhat during the 1990's because of the relatively small number of babies born during the Great Depression of the 1930's. The most rapid increase is expected between the years 2010 and 2030 when the "baby boom" generation reaches age 65.

■ By 2030, there will be about 65 million older persons, 2 and one-half times their number in 1980. If current fertility and immigration levels remain stable, the only age groups to experience significant growth in the next century will be those past age 55.

■ By the year 2000, persons 65+ are expected to represent 13.0% of the population, and this percentage may climb to 21.2% by 2030.

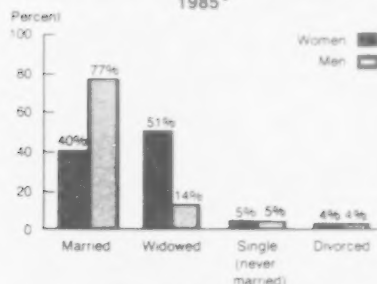
Marital Status

■ In 1985, older men were twice as likely to be married as older women (77% of men, 40% of women—see fig. 2).*

■ Half of all older women in 1985 were widows (51%). There were over five times as many widows (8.0 million) as widowers (1.5 million).*

■ Although divorced older persons represented only 4% of all older persons in 1985, their numbers (over one million) had increased nearly four times as fast as the older population as a whole in the preceding 10 years (3.4 times for men, 4.0 times for women).*

FIGURE 2
MARITAL STATUS OF PERSONS 65+ :
1985*



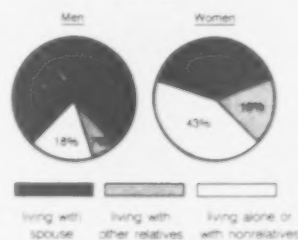
Living Arrangements

■ The majority (67%) of older noninstitutionalized persons lived in a family setting in 1985. Approximately 9.1 million or 82% of older men, and 9.0 million or 57% of older women, lived in families (see fig. 3). The proportion living in a family setting decreased with age. About 14% (7% of men, 18% of women) were not living with a spouse but were living with children, siblings, or other relatives. An additional 3% of men and 2% of women, or 650,000 older persons, lived with nonrelatives.*

*See footnotes on panel 14

■ About 30% (8.1 million) of all noninstitutionalized older persons in 1985 lived alone (6.5 million women, 1.6 million men). They represented 41% of older women and 15% of older men. Older persons living alone increased in number by 64% between 1970 and 1985, about one and one-half times the growth rate for the older population in general.*

FIGURE 3
LIVING ARRANGEMENTS OF PERSONS
65+ : 1985*



■ A 1975 study found that 4 of every 5 older persons have children. Of these, 18% lived in the same household with a child and another 55% lived within 30 minutes of a child. Three-fourths (77%) had seen a child within the previous week.*

■ While a small number (1.3 million) and percentage (5%) of the 65+ population lived in institutions (primarily nursing homes) in 1980, the percentage increased dramatically with age, ranging from 2% for persons 65-74 years to 7% for persons 75-84 years and 23% for persons 85+.

Racial and Ethnic Composition

■ In 1985, about 90% of persons 65+ were White, 8% were Black, and about 2% were other races (including American Indian, Eskimo, Aleut, Asian and Pacific Islander). Persons of Hispanic origin (who may be of any race) represented 3% of the older population.

*See footnotes on panel 14

Geographic Distribution

■ In 1985, about half (49%) of persons 65+ lived in eight states: California, New York, and Florida had over 2 million each, and Illinois, Michigan, Ohio, Pennsylvania, and Texas each had over 1 million.

■ Persons 65+ constituted 13.3% or more of the total population in eleven states in 1985 (see fig. 4): Florida (17.6%); Rhode Island, Arkansas, Pennsylvania, and Iowa (14.0% to 14.9%); and South Dakota, Missouri, Nebraska, Massachusetts, Kansas, and West Virginia (13.3% to 13.9%).

■ In eleven states, the 65+ population increased by 17% or more between 1980 and 1985 (see fig. 5): Alaska (46%); Nevada (41%); Hawaii (30%); Arizona (28%); New Mexico (20%); South Carolina, Utah, and Florida (19% each); Delaware (18%); and North Carolina and Washington (17% each).

■ Persons 65+ were slightly less likely to live in metropolitan areas in 1980 than younger persons (71% of the elderly, 75% of persons under 65). About 32% of older persons lived in central cities, and 39% lived in suburbs.

■ The elderly are less likely to change residence than other age groups. In 1985 only 16% of persons 65+ had moved since 1980 (compared to 45% of persons under 65). The majority (80%) had moved to another home in the same state.*

■ In 1985, about 880,000 persons 65+ had moved to a different state since 1980. Of these, over one-third (35%) had moved from the Northeast or Midwest regions to the South or West (compared to 26% for younger persons).*

FIGURE 4
PERSONS 65+ AS PERCENTAGE OF TOTAL POPULATION: 1985

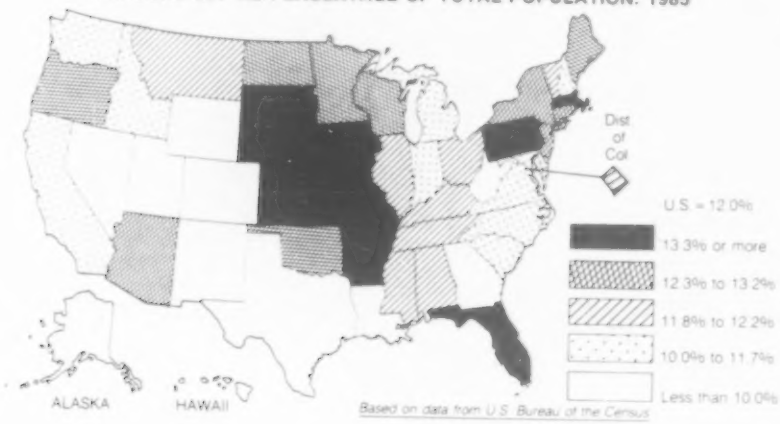


FIGURE 5
PERCENTAGE CHANGE IN 65+ POPULATION: 1980 TO 1985

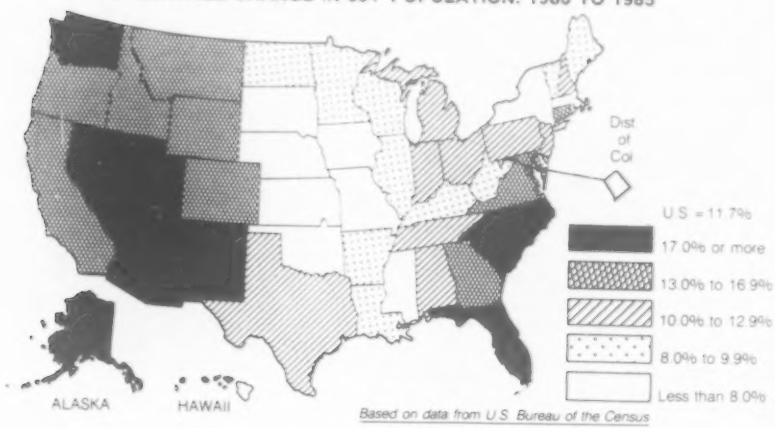


FIGURE 6
THE 65+ POPULATION BY STATE: 1985

State	Number (000's)	Percent of all Ages	Percent Increase	Percent Below Poverty Level
U.S., total	28,530	12.0	11.7	14.8
Alabama	487	12.1	10.7	28.4
Alaska	17	3.2	45.6	14.2
Arizona	392	12.3	27.5	12.2
Arkansas	338	14.3	8.2	28.2
California	2,766	10.5	14.6	8.3
Colorado	285	8.8	15.4	12.8
Connecticut	413	13.0	13.3	8.8
Delaware	70	11.2	18.0	13.6
District of Columbia	76	12.1	2.3	18.9
Florida	2,001	17.6	18.6	12.7
Georgia	594	9.9	14.9	25.7
Hawaii	99	9.4	29.6	10.5
Idaho	109	10.9	16.8	16.0
Illinois	1,368	11.9	8.4	11.9
Indiana	645	11.7	10.2	12.7
Iowa	413	14.3	6.5	13.3
Kansas	326	13.3	6.5	14.2
Kentucky	444	11.9	8.3	23.3
Louisiana	441	9.8	9.1	27.7
Maine	153	13.2	8.9	16.4
Maryland	458	10.4	15.8	12.7
Massachusetts	783	13.4	7.8	9.7
Michigan	1,022	11.2	12.0	12.2
Minnesota	522	12.5	8.9	14.8
Mississippi	310	11.9	7.2	34.3
Missouri	687	13.7	6.0	17.4
Montana	98	11.8	15.4	14.4
Nebraska	217	13.5	5.3	15.5
Nevada	93	8.9	41.4	10.7
New Hampshire	116	11.6	12.8	12.3
New Jersey	954	12.6	10.9	9.9
New Mexico	139	5.6	19.6	21.1
New York	2,254	12.7	4.3	11.6
North Carolina	708	11.3	17.4	23.9
North Dakota	87	12.7	8.2	17.0
Ohio	1,296	12.1	10.8	12.6
Oklahoma	405	12.3	7.7	21.0
Oregon	354	13.2	16.6	11.8
Pennsylvania	1,696	14.3	10.9	11.9
Rhode Island	139	14.4	9.8	12.8
South Carolina	342	10.2	19.2	25.4
South Dakota	97	13.7	6.9	20.2
Tennessee	576	12.1	11.2	25.1
Texas	1,538	9.4	12.2	21.2
Utah	130	7.9	19.1	11.8
Vermont	63	11.8	8.4	13.8
Virginia	587	10.3	16.2	17.3
Washington	505	11.4	17.0	11.3
West Virginia	257	13.3	8.2	18.5
Wisconsin	617	12.9	9.3	9.6
Wyoming	42	8.3	13.1	14.0

(Below Poverty Level figures reflect most recent information available)

Based on data from U.S. Bureau of the Census

*See footnotes on panel 14

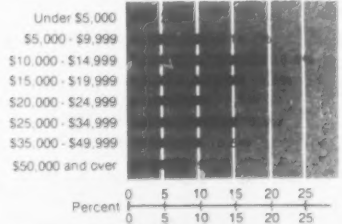
Income

■ The median income of older persons in 1985 was \$10,900 for males and \$6,313 for females. These incomes were each over 4% higher than in 1984, but did not represent increases in "real" income after adjusting for a 1984-85 inflation rate of 3.6%.*

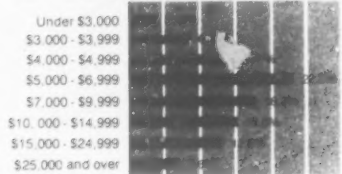
■ Families headed by persons 65+ reported a median income in 1985 of \$19,162 (\$19,815 for Whites and \$11,937 for Blacks). About one of every six (17%) families with an elderly head had incomes less than \$10,000 and 35% had incomes of \$25,000 or more (see fig. 7).*

FIGURE 7
PERCENT DISTRIBUTION BY INCOME: 1985*

Families with head 65+



Unrelated individuals 65+



\$19,162 median for families with heads 65+
\$7,568 median for unrelated individuals 65+

Based on data from U.S. Bureau of the Census

*See footnotes on panel 14

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■ Elderly persons living alone or with nonrelatives were likely to have low incomes in 1985, with nearly half (46%) reporting \$7,000 or less. One-fourth (24%) had incomes under \$5,000, while only 20% had \$15,000 or more. The median income in 1985 for these individuals was \$7,568 (\$7,922 for Whites and \$5,027 for Blacks). *

■ The major source of income for older families and individuals in 1984 was Social Security (35%), followed by asset income (26%), earnings (23%), public and private pensions (14%), and "transfer" payments such as Supplemental Security, unemployment, and veterans' payments (2%). *

■ Older households were more likely than younger households to have one or more members covered by Medicaid in 1984 (13% vs. 9%), but less likely to have received food stamps (6% vs. 9%). About one-fourth (26%) of older renter households lived in publicly owned or subsidized housing (9% for younger renters). *

■ The median net worth (assets minus liabilities) of older households (\$60,300), including those 75+ years (\$55,200), was well above the U.S. average (\$32,700) in 1984. Net worth was below \$5,000 for 16% of older households but was above \$250,000 for 7%. *

Poverty

■ About 3.5 million elderly persons were below the poverty level** in 1985. The poverty rate for persons 65+ was 12.6%, less than the rate for persons under 65 (14.1%). Another 2.3 million or 8% of the elderly were classified as "near-poor" (income between the poverty level and 125% of this level). In total, over one-fifth (21%) of the older population were poor or near-poor in 1985. *

■ One of every nine (11%) elderly Whites was poor in 1985, compared to about one-third (32%) of elderly Blacks and about one-fourth (24%) of elderly Hispanics. *

■ Older women had a higher poverty rate (16%) than older men (8%) in 1985. Likewise, older persons living alone or with nonrelatives were more likely to be poor (26%) than were older persons living in families (6%). *

■ The nine states with the highest poverty rates for older persons in 1979 were all in the South (see fig. 6). Mississippi (34%), Alabama, Arkansas, and Louisiana (28% each), Georgia (26%), South Carolina and Tennessee (25% each), North Carolina (24%), and Kentucky (23%). *

Housing

■ Of the 18.2 million households headed by older persons in 1985, 75% were owners and 25% were renters. Older male householders were more likely to be owners (83%) than were females (66%). *

■ The housing of older Americans is generally older and less adequate than the balance of the nation's housing. About 36% of homes owned by older persons in 1983 were built prior to 1940 (21% for younger owners) and 8% were classified as inadequate (6% for younger owners). *

■ The percentage of income spent on housing (excluding maintenance and repair) in 1983 was higher for older households than for younger households among homeowners without a mortgage (15% vs. 10%), homeowners with a mortgage (24% vs. 20%), and renters (32% vs. 28%). *

■ In 1983, the median value of homes owned by older persons was \$48,800 (\$33,100 for Blacks and \$46,200 for Hispanics). About 83% of older homeowners in 1983 owned their homes free and clear. *

Employment

■ About 11% or 2.9 million older Americans were in the labor force (working or actively seeking work) in 1985, including 1.8 million men and 1.2 million women. They constituted 3% of the U.S. labor force. About 3% of these were unemployed. *

*See footnotes on panel 14.

*See footnotes on panel 14.

■ Labor force participation of older men has decreased steadily, from about 2 of 3 older men in 1900 to 1 of 6 (16%) in 1985. The participation rate for older females rose slightly from 1 in 12 in 1900 to 1 in 10 during the 1950's, but dropped to 1 in 14 (7%) in 1985.*

■ Approximately half (53%) of the workers over 65 in 1985 were employed only part-time. 47% of men and 62% of women.*

■ About 710,000 or 25% of older workers in 1985 were self-employed, compared to 8% for younger workers. Three-fourths of these were men.*

Education

■ The educational level of the older population has been steadily increasing. Between 1970 and 1985, their median level of education increased from 8.7 years to 11.7 years (11.4 years for males, 11.8 years for females), and the percentage who had completed high school rose from 28% to 48%. About 9% in 1985 had 4 or more years of college.*

■ The median number of years of school completed varied considerably by race and ethnic origin among older persons in 1985. 12.0 years for Whites, 8.1 years for Blacks, and 7.1 years for Hispanics.*

Health and Health Care

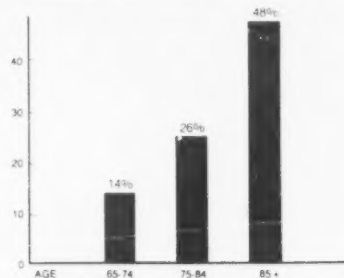
■ In 1984, 32% of older persons assessed their health as fair or poor (compared to 8% for persons under 65). There was little difference between the sexes on this measure, but older Blacks were more likely to rate their health as fair or poor (50%) than were older Whites (31%).*

■ The number of days in which usual activities are restricted because of illness or injury increases with age. Older persons averaged 32 such days in 1984 (30 days for males, 33 days for females, 31 days for whites, 41 days for blacks) and spent all or most of 15 of these days in bed (no difference by sex; 14 days for whites, 21 days for blacks).*

*See footnotes on panel 14

■ In 1982, about 5.1 million older persons living in the community needed the assistance of another person to perform one or more selected personal care or home management activities. This figure represented 20% of noninstitutionalized older persons (17% of males, 22% of females), but the percentage ranged from 14% for persons 65-74 to 26% for persons 75-84 and 48% for persons 85+ (see figure 8). (Selected personal care activities included bathing, dressing, eating, using the toilet, getting in or out of a bed, getting around inside. Selected home management activities included preparing meals, shopping, housework, using a telephone, taking medicine, getting around outside or managing money. Persons were classified as needing assistance if they needed help from another person or a special aid to do one or more of these activities, or could not do one or more of them at all).*

FIGURE 8
PERCENT NEEDING FUNCTIONAL ASSISTANCE, BY AGE: 1982*



Based on data from U.S. Department of Health and Human Services

■ Most older persons have at least one chronic condition and many have multiple conditions. The most frequently occurring conditions for the elderly in 1984 were: arthritis (53%), hypertension (42%), hearing impairments (40%), heart disease (34%), cataracts (23%), orthopedic impairments (19%), sinusitis and visual impairments (14% each), hardening of the arteries (12%), and cerebrovascular disease and diabetes (10% each).*

*See footnotes on panel 14

■ Older people accounted for 30% of all hospital stays and 41% of all days of care in hospitals in 1984. The average length of a hospital stay was 8.9 days for older people, compared to only 5.6 days for people under 65. The average length of stay for older people has decreased over 5 days since 1968 and nearly 2 days since 1980. Older persons also averaged more visits to doctors in 1984 than did persons under 65 (8 visits vs. 5 visits). *

■ In 1984 the 65+ group represented 12% of the U.S. population but was projected to account for 31% of total personal health care expenditures. These expenditures were expected to total \$120 billion and to average \$4,202 per year for each older person, more than 3 times the \$1,300 spent for younger persons. About \$1,000 or one-fourth of the average expenditure was expected to come from direct ("out-of-pocket") payments by or for older persons.

■ Hospital expenses were projected to account for the largest share (45%) of health expenditures for older persons in 1984, followed by physicians and nursing home care (21% each).

■ Benefits from government programs, including Medicare (\$59 billion), Medicaid (\$15 billion), and others (\$7 billion), were projected to cover about two-thirds (67%) of the health expenditures of older persons in 1984, compared to only 31% for persons under 65.

Footnotes:

* Numbers or percentages in paragraphs and figures followed by this symbol refer to the noninstitutionalized population only.

** By the official 1985 definition of \$6,503 for an older couple household or \$5,156 for an older individual living alone.

A Profile of Older Americans: 1986 was prepared by the Program Resources Department, American Association of Retired Persons (AARP) and the Administration on Aging (AoA), U.S. Department of Health and Human Services.

Information researched and compiled by Donald G. Fowles, AoA.

AARP is the nation's largest and oldest organization of over-50 Americans, retired or not. A non-profit, nonpartisan organization with over 22 million members, AARP serves its members through legislative representation at both federal and state levels, educational and community service programs, and direct membership benefits.

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